TRANSCRIPT OF RECORD

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1925

No. 173

FRANK K. BOWERS, COLLECTOR OF INTERNAL REVENUE FOR THE SECOND DISTRICT OF NEW YORK, PLAINTIFF IN ERROR

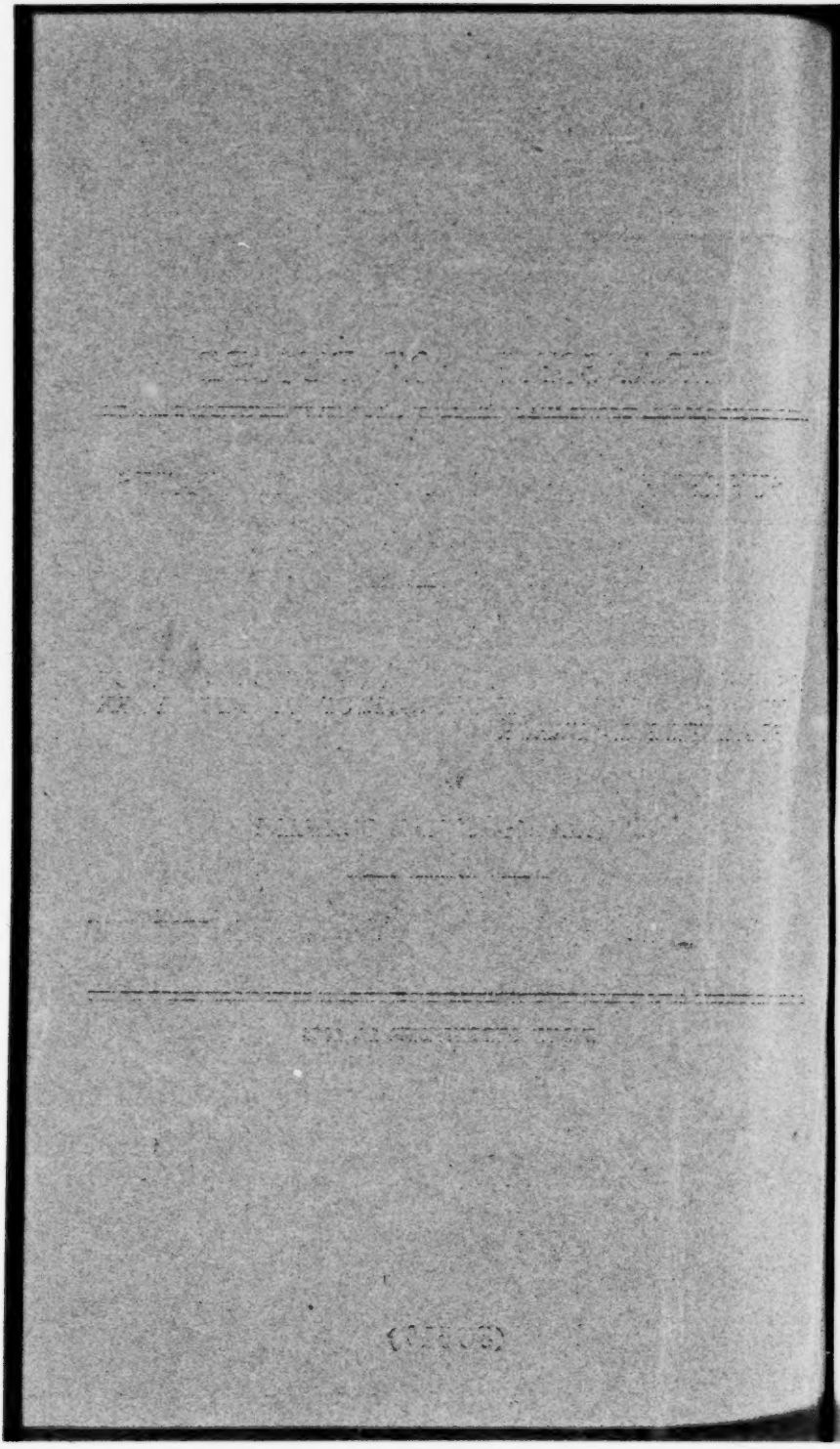
vs.

KERBAUGH-EMPIRE COMPANY

IN ERROR TO THE DISTRICT COURT OF THE UNITED STATES FOR THE SOUTHERN DISTRICT OF NEW YORK

FILED SEPTEMBER 15, 1926

(30617)



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vs.

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1 *Writ of error*

Filed Aug. 16, 1924

UNITED STATES OF AMERICA, *ss:*

The President of the United States of America to the judges of the District Court of the United States for the Southern District of New York, greeting:

Because, in the record and proceedings, as also in the rendition of the judgment of a plea which is in the District Court, before you, or some of you, between Kerbaugh-Empire Company, plaintiff, and Frank K. Bowers, collector of internal revenue, Second New York District, defendant, a manifest error hath happened, to the great damage of the said defendant as is said and appears by his complaint, we, being willing that such error, if any hath been, should be duly corrected, and full and speedy justice done to the parties aforesaid in this behalf, do command you, if judgment be therein given, that then under your seal, distinctly and openly, you send the record and proceedings aforesaid, with all things concerning the same, to the judges of the United States Supreme Court at the city of Washington, together with this writ, so that you have the same at the said place, before the judges aforesaid, on the 15th day of September, 1924, that the record and proceedings aforesaid being inspected, the said judges of the United States Supreme Court may cause further to be done therein, to correct that error, what of right and according to the law and custom of the United States ought to be done.

Witness, the honorable William H. Taft, Chief Justice of
2 the United States, this 16th day of August, in the year of our Lord one thousand nine hundred and twenty-four and of the independence of the United States the one hundred and forty-ninth.

[SEAL.] ALEX. GILCHRIST, Jr.,
Clerk of the United States District Court.

The foregoing writ is hereby allowed.

HENRY W. GODDARD,
U. S. D. J

In United States District Court

Clerk's certificate

I, Alexander Gilchrist, jr., clerk of the District Court of the United States of America for the Southern District of New York, in the Second Circuit, by virtue of the foregoing writ of error and in obedience thereto, do hereby certify that the following pages, numbered from four to eighty-two, inclusive, contain a true and complete transcript of the record and proceedings had in said court in the cause entitled Kerbaugh-Empire Company, plaintiff, defend-

ant in error, vs. Frank K. Bowers, collector of internal revenue, Second New York District, defendant, plaintiff in error, as the same remain of record and file in said office.

In testimony whereof I have caused the seal of the said court to be hereunto affixed, at the city of New York, in the Second Circuit, this 12th day of September, in the year of our Lord one thousand nine hundred and twenty-four and of the independence of the United States the one hundred and forty-ninth.

[SEAL.] ALEX. GILCHRIST, Jr.,
Clerk.

3 [File indorsement omitted.]

4 In United States District Court, Southern District of New York

summons

KERBAUGH EMPIRE COMPANY

against

FRANK K. BOWERS, COLLECTOR OF INTERNAL REVENUE, SECOND NEW York District

To the above-named defendant:

You are hereby summoned to answer the complaint in this action, and to serve a copy of your answer, or, if the complaint is not served with this summons, to serve a notice of appearance on the plaintiff's attorney within twenty days after the service of this summons, exclusive of the day of service. In case of your failure to appear or answer, judgment will be taken against you by default for the relief demanded in the complaint.

Witness, the honorable Learned Hand, Judge of the District Court of the United States for the Southern District of New York, at the city of New York, this 6th day of September, A. D. 1922.

[SEAL.] ALEX. GILCHRIST, *Jr.*, *Clerk.*
KELLOGG & ROSE,
Plaintiff's Attorney.

Office and post-office address, 115 Broadway, Borough of Manhattan, New York City.

5 In United States District Court

[Title omitted.]

Amended complaint

Filed July 2, 1923

The plaintiff above named by Kellogg & Rose, its attorneys, for its amended complaint, complains of the defendant and respectfully shows to this court:

First. That at all the times hereinafter mentioned the plaintiff was and still is a corporation duly organized and existing under and by virtue of the laws of the State of New York.

Second. That the defendant at the time of the making of the return and the payment of the tax as hereinafter set forth was and still is the collector of internal revenue for the United States of America for the Second New York District and is a resident and inhabitant of the Borough of Manhattan, city of New York, in the Southern District of New York.

Third. That this is an action arising under the Constitution of the United States and under various laws of the United States
6 providing for internal revenue, to wit, an act of Congress of the United States of October 3, 1913, entitled "An act to reduce tariff duties and to provide revenue for the Government, and for other purposes," the "revenue act of 1916," the "revenue act of 1917," the "revenue act of 1918," and the "revenue act of 1921."

Fourth. That heretofore and on and prior to June 8, 1911, the plaintiff was the owner of all of the stock of certain subsidiary companies, one of which, H. S. Kerbaugh, Incorporated, a Pennsylvania corporation, was engaged in the performance of large construction contracts.

Fifth. That on June 8th, 1911, the plaintiff was in need of funds for the financing of its subsidiary company, H. S. Kerbaugh, Incorporated, which was then engaged in the performance of certain large contracts, and particularly in the performance of a contract with the city of New York for the construction of the Kensico Dam, known as and hereinafter referred to as contract No. 9. That H. S. Kerbaugh, Incorporated, for the performance of its various construction contracts, and particularly for the performance of the contract known as contract No. 9, was on June 8th, 1911, in need of funds for the financing thereof. That on or about June 8th, 1911, the plaintiff applied to a German banking corporation, the Deutsche Bank of Berlin, Germany, through its American representative, Mr. Edward D. Adams of the city of New York, for loans for the purpose of financing its said subsidiary corporation, H. S. Kerbaugh, Incorporated. That upon plaintiff's said application for loans, the said American representative of the Deutsche Bank, Mr. Ed-
7 ward D. Adams, agreed for and on behalf of said Deutsche

Bank that it would make loans to the plaintiff by cabling to the credit of said Adams in New York City reichmarks (meaning thereby German marks) equivalent to the plaintiff's needs in dollars, upon condition that such loans should be evidenced by notes of the plaintiff drawn to the plaintiff's order and endorsed by it and payable as to both principal and interest in reichmarks (meaning thereby German marks) or their equivalent in United States gold coin at prime bankers' rate in the city of New York for cable transfers to Berlin, Germany, and not in dollars. That plaintiff thereupon agreed with the Deutsche Bank, through its said American representative, that all loans made to it by the Deutsche Bank, pursuant to its application therefor, should be payable in reichmarks and evidenced by notes providing for payment in reichmarks.

Sixth. That beginning on June 8th, 1911, loans were thereafter made from time to time by the Deutsche Bank, through its American representative, Mr. Edward D. Adams, to the plaintiff. That the procedure in the making of such loans was as follows:

1. The plaintiff would advise Mr. Adams, the representative of the bank, of its needs in dollars.

2. Mr. Adams would cable the bank in Berlin for the amount of marks equivalent to plaintiff's need in dollars.

3. The Deutsche Bank would, by cable transfer, credit Mr.
8 Adams in some banking institution in New York with a certain number of marks equivalent to the number of dollars needed by the company

4. Mr. Adams, upon receipt of this credit, would draw his check against the same and hand it to the plaintiff. The credit as received by Mr. Adams as representative of the Deutsche Bank was in marks. The checks for each credit as drawn by Mr. Adams to plaintiff's order were made payable in dollars, and upon their presentation by the plaintiff to the bank against which they were drawn were paid in dollars.

5. In exchange for this check the plaintiff would turn over to Mr. Adams its promissory note payable in reichsmarks.

6. Such notes were turned over to Mr. Adams as the American representative of the Deutsche Bank, and he held them for the bank's account.

7. The interest on the notes was payable in marks the same as the principal. On the dates when the interest was due Mr. Adams advised as to the prevailing rate of exchange and the plaintiff handed to him its check in dollars for the number of marks due.

That between June 8, 1911, and July 1, 1913, both dates inclusive, loans were made to plaintiff, under the circumstances and in the manner hereinbefore set out, by the Deutsche Bank through its said American representative. The amount in dollars actually received by plaintiff, the dates on which such loans were made, and their equivalents in terms of reichsmarks at the prevailing rate of exchange at the time the loans were made were as follows:

Amount received by plaintiff in dollars	Date of receipt by plaintiff	Equivalent in reichsmarks
$50,000.00	June 8, 1911	210,375.00
50,000.00	June 13, 1911	210,375.00
105,000.00	June 20, 1911	441,787.50
100,000.00	Nov. 30, 1911	420,750.00
100,000.00	Feb. 16, 1912	420,800.00
100,000.00	Mar. 15, 1912	419,750.00
50,000.00	Apr. 12, 1912	210,375.00
100,000.00	Apr. 18, 1912	420,750.00
78,000.00	Apr. 24, 1912	328,185.00
50,000.00	May 23, 1912	210,060.00
150,000.00	June 18, 1912	632,130.00
50,000.00	June 24, 1912	210,000.00
100,000.00	July 2, 1912	420,000.00
100,000.00	July 9, 1912	420,250.00
100,000.00	July 22, 1912	420,250.00
50,000.00	Sept. 3, 1912	210,000.00
50,000.00	Sept. 16, 1912	210,500.00
50,000.00	Oct. 7, 1912	211,000.00
100,000.00	Oct. 16, 1912	422,000.00
100,000.00	Apr. 15, 1913	420,625.00
100,000.00	May 15, 1913	420,750.00
100,000.00	May 26, 1913	420,500.00
50,000.00	June 16, 1913	210,125.00
100,000.00	July 1, 1913	420,000.00
$1,983,000.00		8,341,337.50

That for each of said loans so made by the Deutsche Bank to the plaintiff, the plaintiff in the manner as hereinbefore in this paragraph set forth, gave its promissory note to its own order and endorsed by it, dated, and in the amount of reichsmarks as last hereinbefore stated.

Seventh. That between June 8th, 1911, and November 30, 1912, the plaintiff from time to time made payments on account of the loans referred to and set forth in the preceding paragraph to the Deutsche Bank, with the result that the unpaid balance of said loans so made to the plaintiff by the Deutsche Bank, as set forth in the preceding paragraph, amounted to 6,740,800 reichsmarks, which was the balance owing by plaintiff to the Deutsche Bank in reichsmarks on September 1st, 1913, on which said date the Deutsche Bank returned to this plaintiff the several notes given by it to secure the payment to the Deutsche Bank of the loans made to the plaintiff on the dates and in the amounts as set forth in the preceding paragraph, and the plaintiff to evidence the amount then due by it to the said Deutsche Bank, to wit, the balance remaining unpaid of the loans referred to in the preceding paragraph, made, executed, and delivered to the Deutsche Bank its promissory note dated September 1st, 1913, for the amount of 6,740,800 reichsmarks.

Eighth. That thereafter on the due date of said note for 6,740,800 reichsmarks made as alleged in the preceding paragraph of this

amended complaint, to wit, March 1st, 1914, said note of September 1st, 1913, was surrendered to this plaintiff, and the plaintiff thereupon made, executed, and delivered a note dated March 2nd, 1914, payable April 1st, 1915, for 6,740,800 reichsmarks, payable to its own order and duly endorsed by it, and said note, after its said endorsement, was thereupon delivered to the Deutsche Bank. That a copy of the face of the note made by the plaintiff to evidence the indebtedness by plaintiff to the Deutsche Bank in the sum of 6,740,800 reichsmarks, dated March 2, 1914, is annexed hereto and made a part of this amended complaint, as though specifically set forth at length herein, and marked "Exhibit A." That said note was thereafter endorsed in blank by the plaintiff and as so endorsed delivered to the agent of the Deutsche Bank.

11 Ninth. That after the making by plaintiff and the delivery to the Deutsche Bank of the note, Exhibit A, the plaintiff made payments to the Deutsche Bank on account of the principal of said note as follows:

Dates	Reichsmarks
December 31, 1914	1,137,500
January 31, 1915	458,000
March 31, 1915	1,928,855

leaving a balance unpaid of the principal of said note, Exhibit A, of 3,216,445 reichsmarks.

Tenth. That all of the funds borrowed by the plaintiff from the Deutsche Bank in the amounts and on the dates as set forth in the sixth paragraph of this amended complaint were advanced and loaned by the plaintiff to its subsidiary corporation, H. S. Kerbaugh, Incorporated, for use in financing and carrying on various construction contracts under performance by said H. S. Kerbaugh, Incorporated, and principally for use in financing and carrying on the contract of H. S. Kerbaugh, Incorporated, known as contract No. 9. That the prosecution and carrying on by H. S. Kerbaugh, Incorporated, of its said construction contracts resulted in large losses to said H. S. Kerbaugh, Incorporated, and that all of the amounts borrowed by the plaintiff from the Deutsche Bank, as hereinbefore set forth in the sixth paragraph of this amended complaint and by the plaintiff in turn loaned to H. S. Kerbaugh, Incorporated, were lost by H. S. Kerbaugh, Incorporated, in the prosecution and carrying out of its said construction contracts. That H. S. Kerbaugh, Incorporated, reported the losses which it sustained in the prosecu-

12 tion and carrying out of its said construction contracts in its income-tax returns for the years 1913, 1914, 1916, 1917, and 1918, and that the amount of such losses so largely exceeded any income accruing to said H. S. Kerbaugh, Incorporated, in said years as to leave a large excess of losses over and above the income of said H. S. Kerbaugh, Incorporated, in said years referred to, the total of which said excess of losses so reported by said H. S. Kerbaugh, Incorporated, largely exceeded the sum of $684,456.18.

Eleventh. That of the balance of the principal of the note, Exhibit A, owing by plaintiff to the Deutsche Bank on March 31st, 1915, to wit, 3,216,445 reichsmarks, as set forth in paragraph ninth of this amended complaint, the only part of said balance borrowed by the plaintiff from the Deutsche Bank subsequent to March 1st, 1913, was the amount of 1,892,000 reichsmarks.

Twelfth. That on December 3rd, 1917, pursuant to the provisions of a statute of the United States, known as the "Trading with the enemy act," this plaintiff made a report in writing to the Alien Property Custodian, a copy of which said report is hereto annexed and made a part of this amended complaint, as though specifically set forth at length herein, and marked "Exhibit B."

Thirteenth. That on October 2nd, 1919, the Alien Property Custodian addressed a demand to this plaintiff for payment of the balance due on said note, Exhibit A, a copy of which said demand is hereto annexed and made a part of this amended complaint, as
13 though specifically set forth at length herein, and marked "Exhibit C."

Fourteenth. That on July 23rd, 1919, and on November 19th, 1919, plaintiff tendered to the Alien Property Custodian the amount due by it to the holder of said note, Exhibit A, at the then prevailing rates of exchange for reichsmarks. That at the time of the said tender made by the plaintiff to the Alien Property Custodian on November 19th, 1919, the prevailing rate of exchange was 2.18¢ per reichsmark, at which amount plaintiff made its said tender on said date for the balance due of the principal of said note, Exhibit A, to wit, 3,216,445 reichsmarks, with the interest accrued upon said balance of principal similarly figured at the same rate of exchange. That the Alien Property Custodian received said last-mentioned tender as a legal tender, but refused to accept it, claiming an additional amount in dollars. That the plaintiff then deposited the amount so tendered by it to the Alien Property Custodian on November 19th, 1919, with the Central Union Trust Company of New York, for the purpose of keeping its said tender good, and notified the Alien Property Custodian of the fact of the deposit of the amount so tendered with said Central Union Trust Company of New York.

Fifteenth. That thereafter and on the 17th day of August, 1921, a further demand was made by and on behalf of the Alien Property Custodian of this plaintiff for payment of the unpaid balance of the plaintiff's said note, Exhibit A.

14 Sixteenth. That thereafter, and as the result of various negotiations between the plaintiff and the Alien Property Custodian, the plaintiff offered to make payment of the unpaid balance of the principal of said note, Exhibit A, to wit, 3,216,445 reichsmarks, with the interest then accrued thereon, at the rate of 2½¢ per mark, said offer being in writing, a copy of which said offer, dated August 31st, 1921, is hereto annexed and made a part

of this amended complaint as though specifically set forth at length herein, marked "Exhibit D."

Seventeenth. That on the 31st day of August, 1921, the Alien Property Custodian having accepted the plaintiff's said offer, "Exhibit D," the plaintiff paid to the Alien Property Custodian, as successor to and the holder of the rights of the Deutsche Bank, an alien enemy, to receive payment of the unpaid balance of the principal and the accrued interest owing by plaintiff on its said note, Exhibit A, and in full satisfaction and settlement of the claims of the Alien Property Custodian as the said successor of the Deutsche Bank, the sum of $113,688.23, which was in payment of the principal of said note, reichsmarks 3,216,445, and interest to November 15, 1919, reichsmarks 886,589.26, totaling reichsmarks 4,103,034.26, which converted into dollars at the rate of 2½¢ per mark, amounts to $102,575.85, together with interest from the date of demand, November 15, 1919, to the date of payment, September 2, 1921, on said sum of $102,575.85, amounting to $11,112.38, and thereafter received from the Alien Property Custodian a receipt for the payment so made, copy of which said receipt of the Alien Property Custodian is hereto annexed and made a part of this amended complaint, as though specifically set forth at length herein and marked "Exhibit E."

Eighteenth. That the difference in dollars between the average rates of exchange current at the time that the plaintiff borrowed the various sums of the Deutsche Bank, making up the total of 3,216,445 reichsmarks, and the rate of exchange 2½¢ per reichsmark, at which the plaintiff settled with the Alien Property Custodian for the unpaid balance of the note, Exhibit A, to wit, 3,216,445 reichsmarks amounted to the sum of $684,456.18.

Nineteenth. That on the 8th day of February, 1922, the plaintiff asserting and claiming that the said difference in dollars between the amounts received for reichsmarks at the average rates of exchange at the times that plaintiff borrowed the various sums, making up the total of 3,216,445 reichsmarks, and the rate of exchange at which the plaintiff paid the said sum of 3,216,445 reichsmarks to the Alien Property Custodian, as set forth in the preceding paragraphs of this amended complaint numbered seventeenth and eighteenth, amounting to $684,456.18, did not constitute income and did not constitute income, profit, or gain, applied to the Commissioner of Internal Revenue of the United States, pursuant to the provisions of the "revenue act of 1921," for a decision and ruling to that effect and to the effect that said amount of $684,456.18 did not constitute income and did not constitute income, profit, or gain, and was not subject to tax under various laws of the United States providing for internal revenue, to wit, an act of Congress of the United States of October 3, 1913, entitled, "An act to reduce tariff duties and to provide revenue for the Government and for other purposes," the "revenue act of 1916," the "revenue act of 1917,"

the "revenue act of 1918," and the "revenue act of 1921," as income received by the plaintiff during the calendar year 1921.

Twentieth. That thereafter and on the 22nd day of April, 1922, and the 26th day of June, 1922, the Commissioner of Internal Revenue made his ruling or decision in writing upon plaintiff's said application, a copy of which is hereto annexed and made a part of this amended complaint, as though specifically set forth at length in this amended complaint, and marked "Exhibit F." That the said decision of the Commissioner of Internal Revenue was addressed to one Harvey D. Jacob, who was plaintiff's duly constituted attorney in fact and acted for the plaintiff upon said application.

Twenty-first. That the time for the plaintiff to make its return of income pursuant to the provisions of the "revenue act of 1921" for the calendar year 1921 was duly extended to and including the 15th day of June, 1922.

Twenty-second. That on the 13th day of June, 1922, the plaintiff, by reason of the said ruling of the Commissioner of Internal Revenue, Exhibit F, and in order to save itself from having its
17 property seized and levied on under distraint, duly made and filed with the defendant, as collector of internal revenue, second New York district, a corporation income and profits tax return, together with a schedule thereto annexed, known as Schedule A–10, in which said return plaintiff included the said sum of $684,456.18 as income, and on the same date and at the same time paid to the defendant under protest, as in said Schedule A–10 set forth in detail, the sum of $5,198.77, being two one-fourth payments of $2,580.03½ for the first and second quarters of income tax for the calendar year 1921, with interest on the first of said payments from March 15, 1922, to June 13, 1922, and covering the payments as shown by said return made by the plaintiff solely by reason of the circumstances, as hereinbefore in this paragraph set forth. That if said sum of $684,456.18 had not been included in plaintiff's return as income, said return would not have shown any net income to plaintiff during the year 1921, and said payment of $5,198.77 would not have been made by it. That annexed hereto and made a part of this amended complaint, as though specifically set forth at length herein, are copies of said corporation income and profits tax return so made by this plaintiff and filed as aforesaid, and of Schedule A–10 annexed to said corporation income and profits tax return, as hereinbefore referred to, which said papers are marked "Exhibit G" and "Exhibit H," respectively.

Twenty-third. That thereafter, and on or about the 14th
18 day of June, 1922, the plaintiff duly filed, pursuant to the "revenue act of 1921," a claim for refund of said tax, which it claimed to have been erroneously and illegally collected in the amount and under the circumstances as set forth in the preceding paragraph of this amended complaint. That said claim for refund was made and filed according to the provisions of law in that regard. That a copy of said claim for refund is annexed hereto and made

a part of this amended complaint, as though specifically set forth at length therein, and marked "Exhibit I."

Twenty-fourth. That after the filing of said claim for refund as set forth in the preceding paragraph of this amended complaint, the Commissioner of Internal Revenue rejected plaintiff's said appeal and claim for refund in writing on or about the 15th day of June, 1922. That a copy of the rejection by the Commissioner of Internal Revenue of the plaintiff's said appeal and claim for refund is hereto annexed and made a part of this amended complaint, as though specifically set forth at length herein, and marked "Exhibit J."

Twenty-fifth. That the sum of $684,456.18, as set forth in paragraph nineteenth of this amended complaint, was not income and was not income, profit, or gain, and the plaintiff under the Constitution of the United States and various laws of the United States providing for internal revenue, to wit, an act of Congress of the United States of October 3, 1913, entitled "An act to reduce tariff duties and to provide revenue for the Government, and for other purposes," the "revenue act of 1916," the "revenue act of 1917," the "revenue act of 1918," and the "revenue act of 1921," was not required to include it in its said corporation income and profits tax return for the year 1921, and the same was included in said corporation income and profits tax return filed by this plaintiff as set forth in the twenty-second paragraph of this amended complaint, subject to plaintiff's claim and contention that said sum did not constitute income and did not constitute income, profit, or gain, and under protest by this plaintiff. That the said sum of $684,456.18 referred to and set forth in paragraphs eighteenth and nineteenth of this amended complaint was not income, profits, or gain accruing to this plaintiff during the year 1921 or at any other time under the Constitution of the United States and various laws of the United States providing for internal revenue, to wit, an act of Congress of the United States of October 3, 1913, entitled "An act to reduce tariff duties and to provide revenue for the Government, and for other purposes," the "revenue act of 1916," the "revenue act of 1917," the "revenue act of 1918," and the "revenue act of 1921," and if said act of Congress should be construed to tax the said sum of $684,456.18 as income, the same is not warranted by the sixteenth amendment to the Constitution of the United States according to the true construction thereof, and is, therefore, unconstitutional, null, and void. That the tax resulting by reason of the inclusion in plaintiff's said corporation income and profits tax return of said sum of $684,456.18 included therein for the reasons as previously alleged in this paragraph and in paragraph twenty-second of this amended complaint was not a tax based on income, profit, or gain accruing to this plaintiff during the year 1921, or at any other time under said acts last referred to, and if based on the inclusion of said sum of $684,456.18 as income, the levying of said tax was not warranted by the sixteenth amendment to the Constitution of the United States according to the true construction thereof, and

the fixing and levying of said tax in the amount as stated was illegal and unconstitutional.

Wherefore, this plaintiff prays judgment against the said defendant for the sum of $5,198.77, with six per cent interest thereon from the 13th day of June, 1922, together with the costs and disbursements of this action.

KELLOGG & ROSE,
Attorneys for Plaintiff.

Office and post-office address, 115 Broadway, Borough of Manhattan, New York City.

21 [Sworn to by C. A. Nicklas; jurat omitted in printing.]

22 *Exhibit A to complaint*

Rm. 6,740,800. MARCH 2, 1914.

On April 1, 1913, for value received, The Kerbaugh-Empire Company promises to pay to its own order six million seven hundred forty thousand eight hundred reichsmarks (Rm. 6,740,800), at its office in New York City, with interest at the German bank rate as it may be established from time to time, but at not less than 6% per annum, and 1% commission per annum, payable June 1, 1914, and quarterly thereafter, both principal and interest being payable in German reichsmarks or their equivalent in United States gold coin at prime bankers' rate in the city of New York for cable transfers to Berlin, Germany.

THE KERBAUGH-EMPIRE COMPANY,
BY C. A. NICKLAS, *Treasurer.*

Countersigned:
M. A. HAUSCHILD,
Vice President.

That said note was indorsed in blank by the Kerbaugh-Empire Company.

28 *Exhibit B to complaint*

Alien Property Custodian

REPORT OF PROPERTY AND INDEBTEDNESS UNDER SECTION 7 (A), TRADING WITH THE ENEMY ACT (GENERAL)

Penalty

Failure to make this report to the Alien Property Custodian as provided by law (see extract of act below) is punishable by imprisonment for not more than ten years or fine of not more than ten thousand dollars, or both.

The time for the filing of any report which under the act was required to be filed on or before November 5, 1917, has been extended to and including December 5, 1917.

Pursuant to the provisions of section 7(a) of the "Trading with the enemy act," the Alien Property Custodian hereby requires a written statement under oath containing all the particulars specified in this form.

Instructions

(1) Read carefully all of this report form, note the grouping of the several classes of property, and read instructions before beginning to make report. Write legibly, using typewriter where possible.

(2) Person.—The word "person" is defined by section 2 of the act as follows:

"The word 'person,' as used herein, shall be deemed to mean an individual, partnership, association, company, or other unincorporated body of individuals, or corporation or body politic."

(3) The person whose property (including indebtedness owing him) must be reported.—Report must be made of the property or of indebtedness to any person who, by the "Trading with the enemy act," is defined as an enemy or ally of enemy or whom the person making this report may have reasonable cause to believe to be an enemy or ally of enemy.

(4) Enemy.—For the purpose of this report, the word "enemy," as defined by section 2 of the act, includes the following:

"(a) Any individual, partnership, or other body of individuals, of any nationality, resident within the territory (including that occupied by the military and naval forces) of any nation with which the United States is at war, or resident outside the United States and doing business within such territory, and any corporation incorporated within such territory of any nation with which the United States is at war or incorporated within any country other than the United States and doing business within such territory.

"(b) The government of any nation with which the United States is at war, or any political or municipal subdivision thereof, or any officer, official agent, or agency thereof."

Ally of enemy.—For the purpose of this report, the words "ally of enemy," as defined by section 2 of the act, include the following:

"(a) Any individual, partnership, or other body of individuals, of any nationality, resident within the territory (including that occupied by the military and naval forces) of any nation which is an ally of a nation with which the United States is at war, or resident outside the United States and doing business within such territory, and any corporation incorporated within such territory of such ally nation, or incorporated within any country other than the United States and doing business within such territory.

"(b) The government of any nation which is an ally of a nation with which the United States is at war, or any political or municipal subdivision of such ally nation, or any officer, official agent, or agency thereof."

(5) If a person, even an American citizen, is resident within the territory of an enemy or ally of enemy, including that occupied by its military and naval forces, his property must be reported.

(6) The term "enemy" or "ally of enemy," as used in this form, includes any person whom you may have reasonable cause to believe to be an enemy or ally of enemy.

(7) On October 6, 1917, the United States was at war with Germany; the allies of Germany were Austria-Hungary, Bulgaria, and Turkey.

(8) Who must make this report and what must be reported.—This report must be made by the persons described in the following paragraph of the act:

"Any person in the United States who holds or has or shall hold or have custody or control of any property beneficial or otherwise, alone or jointly with others, of, for, or on behalf of an enemy or ally of enemy, or of any person whom he may have reasonable cause to believe to be an enemy or ally of enemy and any person in the United States who is or shall be indebted in any way to an enemy or ally of enemy, or to any person whom he may have reasonable cause to believe to be an enemy or ally of enemy, shall, with such exceptions and under such rules and regulations as the President shall prescribe, and within thirty days after the passage of this act, or within thirty days after such property shall come within his custody or control, or after such debt shall become due, report the fact to the Alien Property Custodian by written statement under oath containing such particulars as said custodian shall require. The President may also require a similar report of all property so held, of, for, or on behalf of, and of all debts so owed to, any person now defined as an enemy or ally of enemy, on February third, nineteen hundred and seventeen."

The Alien Property Custodian, acting under the authority vested in him by the President, including all power and authority to require lists and reports, has issued an order requiring a report of all property so held, and of all debts so owed, on February 3, 1917. If on February 3, 1917, the person reporting so held any property of, for, or on behalf of the person named in division B hereof, or was indebted in any way to such person, an additional report as of February 3, 1917, must be made, unless all such property and indebtedness are included in this report.

(9) The following reports, covered by special forms, are not to be included herein:

(a) Lists required to be filed by corporations incorporated within the United States, unincorporated associations, companies, or trustees within the United States, issuing shares or certificates representing beneficial interests, as to the enemy or ally of enemy officers, directors, or stockholders thereof. (A. P. C. Form No. 101.)

(b) Reports by insurance companies as to all policies of insurance of value, in which an enemy or ally of enemy has any interest. (A. P. C. Form No. 102.)

(c) Reports by banking institutions having no property on hand of an enemy or ally of enemy or owing no debt to an enemy or ally of enemy, except an open bank account. (A. P. C. Form No. 103.)

(d) Reports by corporations or persons leasing safe deposit boxes to enemy or ally of enemy or to lessees in trust for enemy or ally of enemy and to which the lessors have not access. (A. P. C. Form No. 104.)

(e) Executors, administrators, guardians, trustees, receivers, and others acting in a like fiduciary or representative capacity, in respect of property in which an enemy or ally of enemy has an interest. (A. P. C. Form No. 105.)

24 (10) Miscellaneous.—Make separate reports on separate blanks for each person whose property (including indebtedness owing him) is being reported.

(11) Do not leave any schedule or question unanswered. If a negative answer is intended, write "None" or "No."

(12) If the space provided in any schedule in this form is inadequate, a complete schedule in like form and bearing the corresponding schedule number must be prepared, signed, attached to this report, and made a part hereof. Do not put a part of the information in the space on this form and a part on an attached sheet.

(13) If the person making the report holds any of the property mentioned in any of the schedules jointly with others, this fact must be stated in such schedules, with the names and addresses of the joint holders or custodians. Persons holding property jointly may report jointly.

To Alien Property Custodian, Washington D. C.:

The undersigned, in pursuance of the act of Congress known as the "Trading with the enemy act," approved October 6, 1917, hereby makes the following written statement containing the particulars required by the Alien Property Custodian (except as reported on special forms) of all the property, beneficial or otherwise, which the undersigned on October 6, 1917, held, had, or had custody or control of, or now holds, has, or has custody or control of, alone or jointly with others, of, for, or on behalf of the herein-named enemy or ally of enemy, or person whom the undersigned may have reasonable cause to believe to be an enemy or ally of enemy; and of all indebtedness owing on or after October 6, 1917, by the undersigned to such enemy or ally of enemy or person whom the undersigned may have reasonable cause to believe to be an enemy or ally of enemy, to wit:

A

Name of individual, partnership, association, or corporation making report: The Kerbaugh-Empire Company (a New York corporation).

Address: 6 Church, New York, New York, New York.

B

Name of enemy or ally of enemy or person whom person reporting may have reasonable cause to believe to be an enemy or ally of enemy whose property (including indebtedness owing him) is being reported: The Deutsche Bank.

Last known residence or address: Berlin, Germany.

(Give the residence or address of the person whose property is being reported, as the same is registered or recorded on the books of the person reporting, together with any information showing any subsequent change of residence or address.)

Of what country (if known to person reporting) is person whose property is being reported a subject or citizen? Germany.

SCHEDULE 1

Money, checks, and drafts payable on demand

This schedule includes gold, silver, currency, checks, and drafts payable on demand. (Time drafts and bank accounts should be included under Schedule 8.)

Money: None.

Give detailed description, date, bank, drawer or maker, payee, endorser, number of check and amount, place of payment, and the capacity in which the same is held. If any check or draft scheduled is for any reason worth less than its par value, this fact should be stated in this schedule.

Checks: None.

Drafts payable on demand: None.

25 SCHEDULE 2

Stocks and bonds

This schedule includes financial securities, such as certificates of stock, issues of notes and debentures of corporations, associations, companies, or trustees, including certificates representing beneficial interests; bonds and coupons of corporations, countries, States, counties, cities, and subdivisions thereof; and all financial securities commonly dealt in by bankers, brokers, and investment houses.

(The list of officers, directors, and stockholders of corporations and unincorporated associations or companies or trustees issuing shares or certificates representing beneficial interests, required by the first two paragraphs of section 7 (a) of "trading with the enemy act," should be made on a separate form (A. P. C. Form No. 101), which will be furnished on request, and the list there called for should not be included in this report.)

Give in detail name of the corporation or person issuing stock, shares, or certificates representing beneficial interests, bonds, or securities, and class or issue thereof, record or registered owner, par value or principal amount of same, number of shares (if any), and serial numbers of all instruments; state where the same are located and estimated market value of each item: None.

SCHEDULE 3

Equity of enemy or ally of enemy in mortgaged or pledged property and interest of enemy or ally of enemy in contracts mentioned in section 8 (a)

This schedule includes the property and contracts mentioned in section 8 (a) of "trading with the enemy act," which provides: "That any person not an enemy or ally of enemy holding a lawful mortgage, pledge, or lien, or ohter right in the nature of security in property of an enemy or ally of enemy which by law or by the terms of the instrument creating such mortgage, pledge, or lien, or right may be disposed of on notice or presentation or demand, and any person not an enemy or ally of enemy who is a party to any lawful contract with an enemy or ally of enemy, the terms of which provide for a termination thereof upon notice or for acceleration of maturity on presentation or demand, may continue to hold said property, and, after default, may dispose of the property in accordance with law or may terminate or mature such contract by notice or presentation or demand served or made on the Alien Property Custodian in accordance with the law and the terms of such instrument or contract, and under such rules and regulations as the President shall prescribe; and such notice and such presentation and demand shall have, in all respects, the same force and effect as if duly served or made upon the enemy or ally of enemy personally."

Describe in detail each item; the nature, value, and location of the property; the nature, amount, and maturity of indebtedness; give dates of all instruments, amounts, due dates, and parties to the same; and attach copies of all contracts described in section 8 (a) and of all instruments, if any, creating the mortgage, pledge, lien, or other right in the nature of security in property; and state estimated value of equity of enemy or ally of enemy therein: None.

SCHEDULE 4

Warehouse receipts and bills of lading

This schedule includes warehouse receipts, bills of lading issued by any carrier, trust receipts, bills of sale, and other evidences of the title or ownership of tangible personal property not in the actual possession of the person reporting.

Give in detail date of instrument, name of person issuing the same, description, location, and estimated market value of the property covered, and nature of interest in instrument or property of person named in division B hereof: None.

26 SCHEDULE 5

Goods and merchandise

This schedule includes goods, wares, merchandise, chattels, stocks on hand, and tangible personal property in the custody or control of the person reporting, not included in any of the preceding schedules of this report; also ships, or interests in ships, and goods on ships, in which the person named in division B hereof has any interest.

Describe in detail the property, quantity, location, and the estimated market value thereof: None.

SCHEDULE 6

Real estate mortgages

This schedule includes all real estate mortgages where the obligation is held by an enemy or ally of enemy and is secured on specific real estate; all vendors' sales agreements and all land contracts where enemy or ally of enemy is vendor and purchase price of real estate sold by enemy or ally of enemy remains unpaid in whole or in part.

Give full description of indebtedness secured by any mortgage or deed of trust on real estate, together with description of property on which indebtedness is a lien; give amount and maturity of indebtedness, interest payment dates, rates of interest, and copies of all vendors' sales agreements or land contracts, together with statement of amount due and unpaid thereon by purchaser. Also give estimated market value of mortgage and real estate: None.

SCHEDULE 7

Real estate

This schedule includes real estate, leaseholds, ground rents, options, and contracts relating to real estate, together with rents accrued or to accrue.

Give description of real estate, location, grantor and grantee in deed or other instrument, date of instrument, and where recorded; estate held, whether fee simple or otherwise; description of improvements, estimated market value of land and improvements

separately; amount of encumbrances, and probable annual net income; names and addresses of tenants, name and address of agent collecting rents; rents accrued and to accrue: None.

27 SCHEDULE 8

Negotiable instruments and debts—Item 1

The indebtedness hereafter reported under this schedule is not due. We are advised that the indebtedness not being due, we are not required to report it under section 7 (a) of the "trading with the enemy act." The report is made with the reservation as stated in our accompanying letter, dated December 3rd, 1917. The indebtedness in question is as follows:

Promissory note.

Maker: The Kerbaugh-Empire Company.

Payee: The Kerbaugh-Empire Company.

Date of note: March 2nd, 1914.

Amount of note as originally made: 6,740,800 reichmarks.

Interest rate specified: 6%, and in addition the Kerbaugh-Empire Company agreed to pay one per cent commission.

Note endorsed in blank by the Kerbaugh-Empire Company.

Note last known to be in the possession of Hugo Schmidt, believed to be the representative of the Deutsche Bank.

Note now believed to be in possession of Hugo Schmidt and to be held by him for and on account of the Deutsche Bank.

Payments made on account of principal of note: 3,524,355 reichmarks.

Last payment made: March, 1915.

Due date of note as originally made: April 1st, 1915.

Time of payment of indebtedness changed from time loan to loan payable on demand ten days after written notice on April 6th, 1915, when it was agreed in writing that the balance due on said note, 3,216,445 reichmarks, should become payable ten days after written notice to pay same.

Interest on said indebtedness has been paid to June 1st, 1916.

It was agreed that interest accruing thereafter on balance of indebtedness, 3,216,445 reichmarks, need not be paid as it accrued because of the company's financial condition, but should be credited on the company's books as it accrued and added to the balance of principal.

Interest accrued and added to balance of principal to date amounts to 296,158 reichmarks, making total balance of indebtedness 3,512,603 reichmarks, which, under agreement, is not now due and will not become due or payable until ten days after written notice and demand.

No notice to pay principal or interest balance as last stated has been given.

The obligation, when it shall accrue for payment, is payable in reichmarks. It is impossible to estimate in dollars the value of

principal and interest owing, for the reason that the maker is unable to pay the amount of the principal and interest of said indebtedness. No security is held for said obligation.

28 SCHEDULE 8

Negotiable instruments and debts

This schedule includes all indebtedness of person making this report to person named in Division B hereof; and all evidences of debt not included in any of the preceding schedules of this report, such as promissory notes, bills of exchange, time drafts, certificates of deposit, bank accounts or deposits, trade acceptances, royalties (other than royalties on patents, trade-marks, or copyrights), book accounts, accounts payable, judgments, contracts, and any debt or obligation not of the character hereinbefore scheduled, in the custody or control of the person making this report, in which the person named in Division B hereof has or may have an interest. All debts, whether due or not, must be reported. Any unpaid instrument owing by you, which to your knowledge was at any time payable to or held by the person named in Division B hereof, must be reported, together with the name and address of present payee or holder, if known.

(1) Describe in detail each item of indebtedness of person reporting to person named in Division B hereof. Give date of any instruments evidencing such debt or debts, together with date of maturity, rate of interest, date to which interest is paid, place of payment, principal amount unpaid, and estimated value thereof. State names of joint makers, if any, and name all parties to instruments or obligations, and if indebtedness is secured in any way describe the security and state its estimated value.

(2) Describe in detail each evidence of indebtedness held by person reporting, or in his custody or control, of, for, or in behalf of person named in Division B hereof; give nature of same, original principal, amount thereof unpaid, rate of interest and to what date paid, when principal and interest due, and estimated value thereof; give dates of all instruments, amounts, due dates, and parties to or on the same, together with any security held for the payment of any of the obligations and estimated value thereof. Give name of court and court reference to any judgments, and book and page and office where recorded of any recorded instrument: None.

SCHEDULE 9

Patents, trade-marks, and copyrights

This schedule includes all indebtedness incurred under agreements existing prior to the enactment of "Trading with the enemy act,"

October 6, 1917, where the holder of the patent, trade-mark, or copyright is the person named in Division B hereof, and does not include sums owing pursuant to any license issued under that act for the use of patents, trade-marks, and copyrights.

Describe the patent, trade-mark, or copyright; give the commonly accepted name thereof, the serial number thereof, and copy of the agreement under which the same is being used, together with a statement of all royalties due or unpaid: None.

29 SCHEDULE 10

Insurance policies

This schedule includes fire, life, accident, marine, and other policies of insurance in which the person named in Division B hereof is the insured or the beneficiary and which policies are in the custody or control of the person reporting. Insurance companies should report on A. P. C. Form No. 102 policies issued by them, and they should not include such policies herein. Any debt owing by way of premium upon policies of insurance or reinsurance to the person named in Division B hereof should be reported under Schedule 8 as a debt.

Describe in detail, giving name of company, number of policy, amount thereof, the description and location of the person or property insured, name of the beneficiary, address of the insured and beneficiary, if known, amount due on the policy, if any, to person named in Division B hereof, the liens outstanding on the policy, if any, and also whether the policy is in force and whether any arrangement is in existence for the payment of any premium due or to become due thereon: None.

SCHEDULE 11

Safe-deposit boxes

This schedule includes all cases where the person reporting has the custody or control of any safe-deposit box in which, or in any of the contents of which, the person named in Division B hereof has any interest.

Safe-deposit boxes leased by a safe-deposit company or person to enemies or allies of enemy or to lessees in trust for enemies or allies of enemy and to which the lessors have not access should be reported on A. P. C. Form No. 104.

Give name and address of corporation from which safe-deposit box is rented and number and location of the box. The contents of the box in which the person named in Division B hereof has any interest should be reported in the several appropriate schedules of this report: None.

SCHEDULE 12

Report in this schedule all other property, real, personal, or mixed, and assets and claims of every kind and description not otherwise designated in the foregoing schedules, and not required to be separately reported, in which the person named in Division B hereof has or may have any right, title, or interest

List of above property, with full description, location, terms, amounts, and estimated market value of each item: None.

30 The following questions must also be answered by the person making this report:

Did you on February 3, 1917, other than as stated in this report, hold, have, or have the custody or control of any property, beneficial or otherwise, alone or jointly with others, of, for, or on behalf of the person named in Division B hereof, or were you on February 3, 1917, other than as stated in this report, indebted in any way to the person named in Division B thereof? Answer, No.

Did you on February 3, 1917, hold, have, or have the custody or control of any property, beneficial or otherwise, alone or jointly with others, of, for, on behalf of any other person than the one named in Division B hereof, who is an enemy or ally of enemy or whom you may have reasonable cause to believe to be an enemy or ally of enemy and of which you have not yet made report to the Alien Property Custodian, or were you on February 3, 1917, in any way indebted to such other person and have not made report of such debt to the Alien Property Custodian? Answer, No.

(If either question is answered in the affirmative, additional forms will be furnished upon request.)

[SEAL.] (Signed) KERBAUGH-EMPIRE COMPANY,
[SEAL.] (Signed) J. H. MCCLEMENT, *President.*

Affidavit of officer or representative of corporation or association making report

STATE OF NEW YORK,
County of New York, ss:

I swear that I am the president of the corporation making the foregoing report, and that the foregoing report and answers therein made are true and correct.

(Signed) J. H. MCCLEMENT.

Subscribed and sworn to before me this 3rd day of December, 1917.

(Signed) M. F. BOYLAN, [SEAL.]
Notary Public, Bronx Co., No. 75.

Bronx Co. Reg. No. 975. Certificate filed in N. Y. Co., No. 497. Certificate filed in N. Y., Reg. No. 9417. My commission expires March 30th, 1919.

31 [Omitted in printing.]

32 *Exhibit C to complaint*

[Copy]

GBL:KJR. Duplicate—Original Report No. 1863.
Trust No. E-665.

APC-MM-676.
A. P. C. Form No. 106 L.
Blank demand as amended.

ALIEN PROPERTY CUSTODIAN

Demand by Alien Property Custodian for property

To the KERBAUGH-EMPIRE COMPANY,
Address, 6 Church Street, New York City.

I, Francis P. Garvan, Alien Property Custodian, duly appointed, qualified, and acting under the provisions of the act of Congress known as the "trading with the enemy act," approved October 6, 1917, the amendments thereto, the proclamations of the President, and the Executive orders issued in pursuance thereof, by virtue of the authority vested in me by said act as amended, and by said executive orders, after investigation do determine that Deutsche Bank (name of enemy), whose address is Berlin, Germany, is an enemy not holding a license granted by the President, and that that certain obligation and indebtedness representing the unpaid balance on a promissory note in the name of and to the credit of Deutsche Bank, Berlin, Germany, in the amount of 3,512,603 reichmarcks, as of date of December 3, 1917, being equivalent to $632,268.54 (computation at 18 cents per reichsmark), together with any accretions thereto and any interest accrued on the said obligation and indebtedness and on the accretions thereto, is by you owing and held for, on account of, or on behalf of and for the benefit of the said Deutsche Bank, of Berlin, Germany.

I, as Alien Property Custodian, do hereby seize the said obligation and indebtedness and do hereby require that the said indebtedness shall be by you conveyed, transferred, and assigned to me as Alien Property Custodian, to be by me held, administered, and accounted for as provided by law.

I, as Alien Property Custodian, do further require that you note the substance of this seizure and demand upon your books and records with respect to the said obligation and indebtedness.

33 I, as Alien Property Custodian, do further require that you shall forthwith deliver and pay over to me the sum of $632,268.54, together with any accretions thereto and any interest accrued on the said sum and the accretions thereto, on account of the said obligation and indebtedness, to be by me held, administered, and accounted for as provided by law.

Witness my hand and seal of office this 2d day of October, 1919.

[SEAL OF A. P. C.] (Signed) FRANCIS P. GARVAN,
Alien Property Custodian.

34 *Exhibit D to complaint*

12359 NEW YORK, *August 31, 1921.*

Colonel THOMAS W. MILLER,

Alien Property Custodian, Washington, D. C.

DEAR SIR: In compliance with the demand and threat of legal proceedings for the enforcement thereof made on your behalf, under date of August 17, 1921, by Messrs. Duer & Taylor, in connection with notice of this company dated March 2, 1914, for Rm. 6,740,800, on which there remains an unpaid balance of principal amounting to Rm. 3,216,445, with interest at 6% and commission at 1% since June 1, 1916, we hand you herewith our certified check drawn to your order for the sum of $113,688.23, being "the equivalent in dollars, calculated at the average rate of exchange, to wit: 2½¢ per mark, prevailing on November 15, 1919," of the balance of 3,216,445 reichsmarks remaining unpaid of the principal and 886,589.26 reichsmarks interest and commission on said note, and the deferred interest payments to November 15, 1919, totaling 4,103,034.26 reichsmarks, or $102,575.85, together with $11,112.38, representing interest at 6% from November 15, 1919, to September 2, 1921. The calculations are shown on the enclosed statement.

We understand that you have not in your possession and can not therefore return to us the note in question. We have no knowledge and understand that you do not know who actually holds the note in question, although it is your belief and ours that it was and is held by the Deutsche Bank. If by any chance the note is not in the possession of the Deutsche Bank, but is, on the contrary, in the hands of a citizen or corporation of the United States, who acquired it prior to the passage of the trading with the enemy act, without notice, or if under similar circumstances it was acquired by a citizen of a country other than an enemy of the United States, as defined in the trading with the enemy act, we wish it understood that this payment is made under protest, and, reserving our right to claim and enforce the repayment of the amount now paid if in the future such a person or corporation should, after due legal proceedings, compel this corporation to pay a second time the balance of principal and interest due upon such obligation.

In order to protect our rights and preserve our legal position, as above stated, we make the payment under protest and reserving our full rights in the matter.

In view of the fact that the claim as originally made by you and your predecessors was for a larger amount in dollars, and that our offer or tender and claim of balance due on said note was for a lesser amount than we are now paying to you, we desire to have it further expressly understood that the payment made is made in settlement of the dispute as to the amount due, and is made
35 in full satisfaction of any and all claims which might be

asserted for the balance of principal and interest of or arising in connection with the note in question.

We are yours very respectfully,

THE KERBAUGH-EMPIRE COMPANY,
By C. A. NICKLAS, *Secretary & Treasurer.*

36 *Exhibit E to complaint*

Whereas heretofore and on or about the 5th days of November, 1919, Francis P. Garvan, who had theretofore been duly appointed and had qualified and was then acting as Alien Property Custodian under the provisions of the act of Congress known as the trading with the enemy act, approved October 6, 1917, made a demand upon the Kerbaugh-Empire Company for the payment to said Alien Property Custodian of the sum or six hundred and thirty-two thousand two hundred sixty-eight and 54/100 dollars ($632,268.54), which was the equivalent computed at eighteen cents (18¢) per reichsmark of three million five hundred twelve thousand six hundred three (3,512,603) reichsmarks claimed in said demand to be the unpaid balance upon a promissory note for six million seven hundred forty thousand eight hundred (6,740,800) reichsmarks, dated March 2, 1914, made by said The Kerbaugh-Empire Company to its own order and endorsed by it, which note and obligation at its face provided that the principal and interest thereof was payable in German reichsmarks or their equivalent in United States gold coin at prima bankers' rate in the city of New York for cable transfers to Berlin, Germany, said demand reciting that said note and obligation was then owned and did belong to the Deutsche Bank of Berlin, Germany, whom said Alien Property Custodian had theretofore determined to be an enemy not holding a license granted by the President; and

Whereas said The Kerbaugh-Empire Company disputed the right of said Alien Property Custodian to demand or receive payment of said unpaid balance of said note at a rate of eighteen cents (18¢) per reichsmark and refused to pay the same, and claimed that said Alien Property Custodian was entitled to demand and receive payment of said balance of said note in United States currency figured at two and 18/100 cents (2.18¢) in United States currency for each reichsmark, and not at eighteen cents (18¢) per reichsmark; and

Whereas thereafter and on November 19, 1919, said The Kerbaugh-Empire Company duly tendered to said Francis P. Garvan, as Alien Property Custodian, the sum of eighty-nine thousand five hundred fourteen and 70/100 dollars ($89,514.70) in payment of the balance of principal and interest, amounting to four million one hundred six thousand one hundred seventy-nine and 4/100 (4,106,179.04) reichsmarks of the aforesaid note dated March 2d, 1914, said sum of eighty-nine thousand five hundred fourteen and 70/100 dollars ($89,514.70) being the equivalent in United States currency of said four million one hundred six thousand one hundred seventy-nine

and 4/100 (4,106,179.04) reichsmarks, computed at 2.18 cents per reichsmark, the then prevailing rate of exchange, which said tender said Francis P. Garvan, as Alien Property Custodian, refused to accept; and

Whereas thereafter and on the 31st day of August, 1921,
37 said The Kerbaugh-Empire Company paid to the undersigned as Alien Property Custodian the sum of one hundred thirteen thousand six hundred eighty-eight and 23/100 dollars ($113,688.23) in settlement of the dispute as to the amount due on said note, and in full satisfaction of all the aforesaid demands theretofore made by the Alien Property Custodian, and of any and all claims of said Alien Property Custodian in the premises, and the undersigned accepted said sum accordingly:

No, therefore, I, Thomas W. Miller, duly appointed and qualified as Alien Property Custodian under the authority and in pursuance of the act of Congress known as the trading with the enemy act, approved October 6, 1917, and pursuant to the authority granted to me as said Alien Property Custodian by said act and the acts amendatory thereto, do hereby acknowledge the receipt from the Kerbaugh-Empire Company of the sum of one hundred thirteen thousand six hundred eighty-eight and 23/100 dollars ($113,688.23) which I have accepted in settlement of the controversy regarding the amount to be paid by said The Kerbaugh-Empire Company on the aforesaid promissory note dated March 2, 1914, and in full and complete satisfaction and payment of the entire balance of principal and interest due on said note, and in full and complete satisfaction of all claims and demands heretofore made by me or by my predecessors in the office of Alien Property Custodian in respect of said note and the obligation of said The Kerbaugh-Empire Company thereon.

Witness my hand and seal of office this 9th day of January, 1922.

[SEAL.] (Signed) THOMAS W. MILLER,
Alien Property Custodian.

Witness:
McKENZIE MOSS.

38 *Exhibit F to complaint*

TREASURY DEPARTMENT,
Washington, April 22, 1922.

Office of Commission of Internal Revenue

Address reply to Commissioner of Internal Revenue and refer to IT:R:RR AM.

Mr. HARVEY D. JACOB,
Attorney at Law, Woodward Building, Washington, D. C.

SIR: Receipt is acknowledged of your letter dated February 8, 1922, in which you set forth in detail certain facts relating to a loan made by the Deutsche Bank of Berlin, Germany, to the Kerbaugh-

Empire Company, of New York, and the payment of the loan to the Alien Property Custodian. Briefly stated, these facts are as follows:

The Kerbaugh-Empire Company is a holding company, whose subsidiaries are and have been engaged in general construction work. In 1911 the Kerbaugh-Empire Company entered into negotiations with the Deutsche Bank, through its New York representative, for the loan of various amounts, the advances to be used in general construction work carried on by its subsidiaries. After an exchange of cables, the Deutsche Bank agreed to extend a line of credit to the Kerbaugh-Empire Company, but would only accept notes made payable in German marks. The company objected to the transaction being in marks, but inasmuch as the bank would only accept notes so drawn the officers of the company acquiesced. The loans were made in accordance with the following procedure:

1. The company would advise Mr. Adams, the representative of the bank, of its needs.

2. Mr. Adams would cable the bank at Berlin.

3. The Deutsche Bank would, by cable transfer, credit Mr. Adams in some banking institution in New York with a certain number of marks equivalent to the number of dollars needed by the company.

4. Mr. Adams upon receipt of this credit would draw his check against the sum and hand it to the company.

5. In exchange for this check the company would turn over to Mr. Adams its promissory note payable in equivalent marks.

39 6. These notes were turned over to Mr. Adams, as the American representative of the Deutsche Bank, and he held them for the bank's account.

7. The interest on the notes was payable in marks, the same as the principal. On the dates when the interest was due, Mr. Adams determined the prevailing rate of exchange and the company handed to him its check in dollars to his order for the number of marks due.

Between June, 1911, and July, 1913, the Deutsche Bank had advanced to the Kerbaugh-Empire Company 8,341,337.50 marks and the Kerbaugh-Empire Company had repaid to the Deutsche Bank the sum of 5,124,892.50 marks. The rate of exchange at which the advances were received was about 24¢ per mark. The balance due the Deutsche Bank was 3,216,445 marks, represented by one note. No loans were made after this, and this note was outstanding when the United States entered the war. The equivalent of this amount in round numbers was $800,000. After the United States entered the war the Kerbaugh-Empire Company was requested to report to the Alien Property Custodian any funds it might have belonging to the Deutsche Bank, and on December 3, 1917, the Company reported the situation with reference to the line of credit afforded it by the bank. Inasmuch as the note was a demand note, the Alien Property Custodian demanded that the

Kerbaugh-Empire Company pay over to him the amount of the note and interest, although it was explained to the Alien Property Custodian that the understanding between the bank and the company at the time the note was made was that it would not be demanded until it was entirely convenient for the company to pay it. Negotiations were entered into with the Alien Property Custodian with a view to liquidating the claim which the Alien Property Custodian might have in reference to the matter. It was discovered that the Alien Property Custodian did not have the note and did not know where the note was. Nevertheless, he demanded that the indebtedness be settled, and threatened to bring suit against the company unless settlement was made. After considerable dispute, the matter was finally compromised, and the company under protest paid to the Alien Property Custodian $113,688.23, in full settlement of the dispute and of all claims of the Alien Property Custodian to the 3,216,445 marks and interest due the Deutsche Bank, the rate of exchange used in determining the dollar equivalent to the marks being slightly above the prevailing current rate of exchange. This payment was made in 1921, and the Alien Property Custodian accepted the said sum in full settlement of "the dispute as to the amount due on said note, and in full satisfaction of all the aforesaid demands made by the Alien Property Custodian in the premises," as shown in the release given to the company by the Alien Property Custodian.

You ask whether any taxable gain has accrued to the Kerbaugh-Empire Company from the transaction; and if so, when and how it should be returned.

40 You are advised that careful consideration has been given to the inquiries presented by you. The borrowing of money and the payment of the loan is a capital transaction which ordinarily does not result in a taxable gain or a deductible loss. When, however, the transaction is in foreign money, it must be viewed from the standpoint of dollars in order to determine whether a gain or loss has been sustained.

In the instant case the Kerbaugh-Empire Company received a large amount of dollars from the sale of the borrowed marks, and when the loan was repaid in 1921 the company purchased the required number of marks with a much less amount of dollars. Thus a large gain resulted to the Kerbaugh-Empire Company.

It is held, therefore, that the difference between the amount in dollars received by the Kerbaugh-Empire Company in 1913 and the amount in dollars paid to the Alien Property Custodian in 1921 pursuant to his demand is income to the Kerbaugh-Empire Company for the year 1921.

Respectfully,

D. H. BLAIR,
Commissioner.

TREASURY DEPARTMENT,
Washington, June 26, 1922.

Office of Commissioner of Internal Revenue

Address reply to Commissioner of Internal Revenue and refer to IT:E:RR AM.

Mr. HARVEY D. JACOB,
Attorney at Law, Woodward Building, Washington, D. C.

SIR: Reference is made to the last paragraph of office letter dated April 22, 1922, which reads as follows:

"It is held, therefore, that the difference between the amount in dollars received by the Kerbaugh-Empire Company in 1913 and the amount paid to the Alien Property Custodian in 1921 pursuant to his demand is income to the Kerbaugh-Empire Company for the year 1921."

You are advised that this paragraph should read:

"It is held, therefore, that the difference between the dollar
41 value in 1913 of the outstanding note for 3,216,445 marks given by the Kerbaugh-Empire Company to the Deutsche Bank and the amount paid in dollars to the Alien Property Custodian in 1921 pursuant to his demand is income to the Kerbaugh-Empire Company for the year 1921.

Respectfully,

D. H. BLAIR,
Commissioner.

B

42 *Exhibit G to complaint*

CORPORATION INCOME AND PROFITS TAX RETURN FOR CALENDAR YEAR 1921

(Print plainly corporation's name and business address)

The Kerbaugh-Empire Company and subsidiaries, viz., Bellwood Engineering Co., Inc., Empire Engineering Company, Inc., and Interlake Engineering Co., Inc., 6 Church Street, New York City, N. Y.

Kind of business, contractors—engineers.

SCHEDULE A—TAXABLE NET INCOME

GROSS INCOME

1. Gross sales, less returns and allowances	None.
2. Less cost of goods sold, exclusive of items called for separately below (from Schedule A 2)	None.
3. Gross income from operations other than trading or manufacturing, less allowances (from Schedule A 3)	$2,409,845.32
4. Taxable interest on Liberty bonds, etc. (from Schedule A 4)	None.
5. Taxable interest from all other sources	23,929.89
6. Rents	None.
7. Royalties	None.

GROSS INCOME—continued

8.	Share of net income earned by personal service corporation (whether received or not)	None.	
9.	Dividends on stock of foreign and domestic corporations	None.	
10.	Gross income from all other sources (not including any amount reported in item 23, below) (from Schedule A 10)	$684,456.18	
11.	Total of items 1 to 10		$3,118,231.39

DEDUCTIONS

12.	Expenses (except amounts reported in item 2 above, or called for separately below) (from Schedule A 12)	$2,659,824.17	
13.	Compensation of officers (in whatever form paid) (from Schedule A 13)	63,928.01	
14.	Repairs (including labor, supplies, etc.) (from Schedule A 14)	None.	
15.	Interest (see page 2 of instructions, paragraph 9)	27,471.82	
16.	Taxes (from Schedule A 16)	5,239.80	
17.	Bad debts (from Schedule A 17)	None.	
18.	Exhaustion, wear and tear (including obsolescence) (from Schedule A 18)	77,984.69	
19.	Depletion (from Schedule A 19)	None.	
20.	Amortization of war facilities (from Schedule A 20)	None.	
21.	Total of items 12 to 20		2,834,448.49
22.	Item 11 minus item 21		283,782.90
23.	Profit or loss on sales of capital assets and miscellaneous investments (from Schedule A 23) (loss)	$180,581.49	
24.	Losses by fire, storm, etc. (from Schedule A 24) (extend difference between or sum of items 23 and 24)	(Loss.)	180,581.46
25.	Net income exclusive of deductions for dividends (item 22 minus 24, extended)		103,201.41
26.	Dividends deductible under section 234 (a) 6 of the revenue act of 1921 (from Schedule A 26)		None.
27.	Net income (item 25 minus item 26) (if return is for a period less than 12 months, see page 1 of instructions, paragraph 10)		103,201.41

SCHEDULE B—INVESTED CAPITAL

1.	Capital, surplus, and undivided profits at beginning of taxable period (from Schedule E, item 11)	2,820,000.00
2.	Plus adjustments by way of additions (from Schedule F, item 4)	None.
3.	Total	2,820,000.00
4.	Less adjustments by way of deductions (from Schedule G, item 7)	None.
5.	Remainder	2,820,000.00
6.	Plus or minus changes in invested capital during taxable period (net increase or decrease from Schedule H)	None.
7.	Total (or remainder)	2,820,000.00
8.	Less deduction on account of inadmissible assets (from Schedule J)	None.
9.	Invested capital for taxable period	2,820,000.00

SCHEDULE C—EXCESS PROFITS CREDIT

1. Eight per cent of invested capital for taxable period (item 9 of Schedule B)	$225, 600. 00
2. Exemption ($3,000) (except for a foreign corporation or a corporation satisfying the conditions provided in section 262 of the act)	3, 000. 00
3. Excess profits credit (item 1 plus item 2)	228, 600. 00

SCHEDULE D—COMPUTATION OF TAXES

1. Brackets	2. Net income (item 27, Schedule A)	3. Excess profits credit (item 3, Schedule C)	4. Balance subject to tax	5. Rate	6. Amount of tax
1. Net income, not in excess of 20% of invested capital	$103, 201. 41	$228, 600. 00	None.	20%	None.
2. Balance of net income	None.		None.	40%	None.
3. Totals computed under section 301(a)	103, 201. 41	228, 600. 00	None.		None.

4. Excess profits tax, if computed under sections 302, 303, 304(c) or 337 of the revenue act of 1921 (see page 2 of instructions, paragraph 14)	None.
5. Net income (item 27, Schedule A)	$103, 201. 41
6. Less: Taxable interest on obligations of United States (item 4, Schedule A)	None.
7. Excess profits tax (item 3 or 4, whichever is smaller, in column 6, Schedule D); or	None.
8. Profits taxes, if income from Government contracts exceeds $10,000 (item 16, Form 11208)	None.
9. Exemption of $2,000 for domestic corporation having a net income not exceeding $25,200	None.
10. Balance (item 5, less items 6, 7, and 9, or items 6, 8, and 9)	103, 201. 41
11. Income tax (10% of item 10)	10, 320. 14
12. If net income does not exceed $25,200, enter amount in excess of $25,000	
13. Total tax (item 3 or 4 the lesser, or 8, plus items 11 and 12)	10, 320. 14
14. Less: Income and profits taxes paid to foreign countries or possessions of the United States (attach Form 1118)	None.
15. Tax paid at the source (see section 237 of the revenue act of 1921)	None.
16. Balance of tax (item 13 minus items 14 and 15)	10, 320. 14

SCHEDULE E.—CAPITAL, SURPLUS, AND UNDIVIED PROFITS AS SHOWN BY BOOKS BEFORE ANY ADJUSTMENTS ARE MADE THEREIN

E4. Stock actually outstanding at the end of the preceding taxable period should be entered in this schedule to the extent that it is paid up. If stock or shares were issued at a nominal value or without par value, the entries should reflect the amounts on the books in respect thereof at the close of the preceding taxable period.

E5. This item should include paid-in surplus as shown by books at the end of the preceding taxable period. If any amount is claimed under section 326 (a) 2 of the revenue act of 1921, the amount claimed should be entered under item 1, Schedule F, and not in this schedule.

E7. Reserves which represent allocations of surplus and were not accumulated through deductions made in computing net income as returned in pre-

vious years may, if properly explained, be entered as item 7. Such entries should be identified and if necessary reconciled with balance-sheet reserves.

E10. If the corporation had on hand at any time during the taxable period any treasury stock, copies of the journal entries covering the original issuance, repossession and any subsequent adjustments should be furnished. Treasury stock includes all stock reacquired by the corporation and not canceled, regardless of the reason for the reacquisition.

Item	Amount
Capital stock paid up and actually outstanding at the close of the preceding year:	
1. First preferred	$1,200,000
2. Second preferred	
3. Common	2,000,000
4. Total	3,200,000
Surplus and undivided profits:	
5. Paid-in surplus	
6. Earned surplus and undivided profits	
7. Reserves, additions to which are not deductible in computing net income (to be reconciled with balance-sheet items)	
8. Other items (to be detailed)	
9. Total of items 4, 5, 6, 7, and 8	3,200,000
10. Deduction on account of treasury stock	380,000
11. Capital and surplus at beginning of taxable period as shown by books	2,820,000

SCHEDULE F.—ADJUSTMENTS BY WAY OF ADDITIONS

F1. If an addition to invested capital is claimed in item 1, Schedule F, submit a statement showing (a) the kind of property, (b) the year in which it was paid in, (c) from whom acquired, explaining his relationship to the corporation, (d) the actual cash value of such property at the date when paid in, (e) the par value of stock or shares issued therefor and the amount at which such property was entered in the accounts, (f) the basis upon which the actual cash value of the property was determined and the date when such determination was made, and (g) the amount of depreciation sustained on such property from the date of acquisition to the beginning of the taxable period.

F2. If an addition to invested capital is claimed in item 2, Schedule F, submit a statement showing (a) the kind of property, (b) the year in which it was acquired, (c) its cost, (d) the amount of depreciation sustained on such property from the date of acquisition to the beginning of the taxable period. State also whether each item sought to be restored was actually used or usable at the beginning of the taxable period. Were these expenditures, when made, written off in lieu of depreciation? ------. If so, explain what adjustments have been made to provide for depreciation in view of the proposed restoration to surplus. Additions in this item are cumulative to the beginning of the taxable period. For all additions hereunder provision must be made for depreciation to the beginning of the taxable period.

F3. If any addition to invested capital is claimed in item 3, Schedule F, state specifically the amount of depreciation written off each year in the books of the company and the amount allowed as a deduction in computing net income. Additions to this item are cumulative to the beginning of the taxable period.

Item	Amount
1. Actual cash value of tangible property clearly and substantially in excess of par value of stock issued therefor or of the cash or other consideration paid therefor (see sec. 326 (a) 2 of the revenue act of 1921)	None.
2. Additions to surplus (see sec. 326 (a) 3 of the act)	None.
3. Depreciation or depletion charged in the accounts of the corporation but disallowed by the department as a deduction on income tax returns	None.
4. Total	None

SCHEDULE G.—ADJUSTMENTS BY WAY OF DEDUCTIONS

G1. Is any patent, copyright, secret process, or formula, good will, trademark, trade brand, franchise, or other similar intangible property, paid in for stock, carried as an asset by the corporation? _____ If not entered specifically as such, is the intangible value merged under any other title or titles on the books or balance sheets submitted with this return? _____ Is it entered on the books at a value in excess of its actual cash value when paid in? _____ In excess of the par value of the stock issued therefor? _____ Is the aggregate of such assets acquired prior to March 3, 1917, entered on the books at a value in excess of 25 per cent of the par value of the stock outstanding on March 3, 1917? _____ Is the aggregate of such assets entered on the books at a value in excess of 25 per cent of the par value of the stock outstanding at the beginning of the taxable period? _____

If the answer to any of the foregoing questions is "yes," submit a statement showing separately with respect to such assets acquired (1) before March 3, 1917, and (2) on or after that date, (a) date of acquisition; (b) cash value at that date, with a complete explanation of the basis upon which such cash value was determined; (c) par value of the stock issued therefor; (d) par value of total stock outstanding March 3, 1917; (e) par value of total stock outstanding at the beginning of the taxable period; (f) the value at which such assets are entered on the books of the corporation.

If all the intangibles were acquired before March 3, 1917, the amount by which (f) exceeds (b), (c), 25 per cent of (d), or 25 per cent of (e), whichever is lowest, must be entered as item 1, Schedule G, for the taxable period.

If the intangibles were acquired on or after March 3, 1917, the amount by which the entry in (f) relating to such intangibles exceeds (b) or (c) relating thereto, or 25 per cent of (e), whichever is lowest, must be included in item 1, Schedule G, for the taxable period: Provided, That if intangibles were acquired before March 3, 1917, and also on or after that date, deduction shall be made so that the amount included in invested capital for the aggregate of intangibles shall not exceed 25 per cent of the par value of the total stock outstanding at the beginning of the taxable period.

NOTE.—If the stock of the corporation was issued at a nominal value or without par value, for the purpose of the computation under item 1, the par value shall be deemed to be the fair market value as of the date or dates of issue. The aggregate value so determined of stock outstanding on March 3, 1917, or at the beginning of the taxable period, shall be the basis for the computation.

G2. Is any tangible property, paid in for stock, carried as an asset by the corporation? _____ If so, is it entered on the books at a value in excess of its actual cash value when received? _____ In excess of the par value of the stock paid therefor? _____

If the answer to either of the last two questions is "yes," submit a statement showing (a) kind of property, (b) when acquired, (c) par value of the stock paid therefor, (d) actual cash value of the property when paid in, (e) the basis on which that value was determined, (f) value at which the property is entered on the corporation's books, and (g) amount by which such value exceeds the allowable value under section 326 (a) 2 of the revenue act of 1921. Enter this amount as item 2, Schedule G, for the taxable period.

G3. Was the business reincorporated, reorganized, or consolidated or was its ownership changed or was there a change in ownership of property after March 3, 1917? _____ If so, answer the following questions:

(a) Did an interest of 50 per cent or more in the business or in the property which changed ownership remain in the control of the same persons, corporations, associations, or partnerships, or of any of them? _____

(b) Were any of the assets entered on the books of the corporation making this return at a higher value than on the books of its predecessor? _____

(c) If such previous owner was not a corporation, attach a statement showing (1) the cost of acquisition to the previous owner of any asset so transferred or received, (2) expenditures subsequent to that date for betterment or development not deducted as expense or otherwise since March 1, 1913, by such previous owner, (3) the allowance for depreciation, depletion, or impairment since the date of acquisition by such previous owner.

(d) If all, or substantially all, of the property was acquired from a corporation during the taxable period, attach hereto balance sheets of such predecessor corporations as at the beginning of the taxable period and as at the date immediately prior to the transfer of the property to the corporation mak-

ing the return, and also a balance sheet or statement of the corporation making this return showing the values at which such property received or transferred were entered on the books.

For the purpose of determining invested capital each asset so transferred shall be allowed a value (a) not greater than would have been allowed to the previous owner, if a corporation; or, (b) if not a corporation, at its cost to such previous owner, with proper adjustments for losses and improvements.

G4. Is any property (including physical property, securities, and intangible property) paid for with cash or with other tangible property entered on the books of the corporation at a value in excess of the amount of cash paid therefor or the actual cash value of the tangible property paid therefor? _____. If so, submit a statement showing (a) kind of property, (b) amount of cash paid therefor, (c) actual cash value of other tangible property paid therefor, (d) how that value was determined, (e) value at which the property is entered on the books of the corporation, and (f) excess of (e) over (b) or (c). This excess must be entered as item 4, Schedule G, for the taxable period.

G5. Has adequate provision been made in the accounts of the corporation for (a) losses of every kind? _____, (b) depreciation? _____, (c) obsolescence? _____, (d) depletion of mineral deposits, timber supplies, and the like? _____.

If adequate charge has not been made for depreciation, depletion, obsolescence, and other losses, and the value of the property has not been maintained by replacements that have been charged to expense, proper additional charges therefor must be computed for all years in which they were not made on the books, and the total amount of such charges must be entered as item 5, Schedule G.

G6. Did the corporation ever receive a stock dividend on stock owned in another corporation? _____. If the answer is "yes," state in detail for each stock dividend received, (a) date received, (b) from whom received, (c) number of shares received, (d) par value of shares received, (e) value at which entered on its books of account, (f) whether or not surplus was increased by this value. If answer to (f) is "yes," enter the amount by which surplus was increased as item 6, Schedule G. If answer is "no," state the account in which it was included, (g) date of sale of any of the shares of stock received as a stock dividend, (h) number of shares sold, (i) amount received therefor.

NOTE.—If answers to the foregoing questions indicate that stock dividends received at any time have been treated as an increase of surplus, and such increase is reflected in the computation of invested capital in returns for any or all of the taxable periods 1917, 1918, 1919, and 1920, amended returns should be filed for such taxable period or periods in which this error occurred.

	Item	Amount
1.	Valuation of patents, copyrights, secret processes, or formulæ, good will, trade-marks, trade brands, franchises, or other intangible property	None.
2.	Valuation of tangible property paid in for stock	None.
3.	Valuation of assets acquired in reorganizations	None.
4.	Appreciation	None.
5.	Depreciation, depletion, and other losses	None.
6.	Stock dividend on stock held in another corporation	None.
7.	Total deduction	None.

SCHEDULE H.—CHANGES IN INVESTED CAPITAL DURING TAXABLE PERIOD

1. Changes in invested capital during the taxable period ordinarily arise in one or more of the following ways:

Additions—

(a) By sale of capital stock for cash or by the issue of capital stock for tangible or other assets.

(b) By payment of assessments by stockholders or by creation of paid in surplus by contribution of stockholders.

Deductions—

(c) By liquidation of part of the capital by retirement of stock or by purchase of treasury stock not out of current earnings.

(d) By payment of cash dividends out of earnings of prior years.

(e) By payment of Federal income and profits taxes for previous years.

The changes with respect to taxes will occur in nearly every case. Should no changes be noted, the reason for the omission should be stated.

2. The following instructions should be followed in making the above adjustments; each item should be designated as an addition or deduction, deduction being designated by red ink:

(a) If stock is issued for cash, the actual cash received (but not the amount of discount) should be entered in this schedule. Assets (other than cash) paid in for stock must be valued in accordance with section 326 (a) 2 of the revenue act of 1921.

(b) If capital stock of the corporation is reacquired but not paid for out of current profits, the cost of such stock should be deducted from invested capital.

(c) Report dividends paid out of profits of prior years but not dividends paid out of profits of the taxable period. Any distribution made during the first 60 days of the taxable period shall be deemed to have been made from earnings or profits accumulated during preceding taxable years; but any distribution made during the remainder of the taxable period shall be deemed to have been made from the profits for that period to the extent that such profits are sufficient. (See section 201 (f) of the revenue act of 1921.)

(d) The amount of Federal income and profits taxes payable should be prorated and deducted as of the dates when due and payable whether reserves have been set up on the books or not. The average adjusted deduction to be entered in column 7 equals total income and profits tax multiplied by 0.4226.

3. The data called for in columns 1 to 5 should be given for all transactions, except that columns 3 and 4 are applicable only to the issue or reacquisition of the late corporation's stock.

4. In column 6 enter the number of days remaining in the taxable period (including the date of change).

5. The net changes not reported in Schedule L, if not in accordance with the increases or decreases reflected in the balance sheets, should be fully reconciled therewith.

1. Nature of additions and deductions	2. Date	3. Number of shares sold or reacquired	4. If for cash, state price per share	5. Amount of cash or cash value actually received or paid out	6. Number of days effective	7. Adjusted average $\left(\frac{\text{Column 5} \times \text{Column 6}}{\text{No. days in taxable period.}}\right)$
1			$	$		$
2						
3						
4						
5						
6						
7						
8						
9. Net increase or decrease						

None.

SCHEDULE J.—INADMISSIBLE ASSETS

Has the corporation any inadmissible assets (i. e., stocks, bonds, and other obligations, except obligations of the United States, the income from which is not taxable)? _____

If so, attach hereto a statement showing for the taxable period the facts called for in items (a) to (j) of this schedule.

If the income from such assets consists in part of gain or profit from the sale or other disposition thereof, or if all or part of the interest derived from such assets is in effect included in the net income because of the limitation on the deduction of interest under section 234 (a) 2 of the revenue act of 1921, then a corresponding part of the capital invested in such assets is deemed an admissible asset. In such case set forth in detail—

(a) The various kinds of income derived from such assets and the computation of the part of the capital invested therein which is deemed an admissible asset.

For the purpose of this schedule inadmissible assets shall be valued at cost of acquisition, except that if the corporation is a dealer in securities and inventories such securities in determining its net income, such inventory figure shall constitute the measure of value. Admissible assets shall be valued as provided in sections 326 and 331 of the revenue act of 1921. The average amount of assets of each kind held during any year may ordinarily be determined by dividing by 2 the sum of the amount of such assets held at the beginning of the taxable period and the amount held at the end of the taxable period. In such case the amount of admissible assets may best be determined from (1) the balance sheet as at the beginning of the period adjusted with respect to the terms in Schedules F and G and (2) the balance sheet as at the end of the period correspondingly adjusted. But if at any time during the taxable period a substantial change has taken place in the amount of such assets, the average amount must be determined as provided in the regulations issued under authority of the revenue act of 1921. In such case show in detail—

(b) The computation of such amount;
(c) Amount of inadmissible assets held at beginning of the taxable period;
(d) Amount of inadmissible assets held at end of taxable period;
(e) Average amount of inadmissible assets held during taxable period;
(f) Amount of admissible assets held at beginning of taxable period;
(g) Amount of admissible assets held at the end of taxable period;
(h) Average amount of admissible assets held during taxable period;
(i) Sum of (e) plus (h);
(j) Percentage which (e) is of (i).

This percentage (j) should be applied to the amount appearing on line 7, Schedule B, in order to obtain the deduction on account of inadmissible assets, which should be entered on line 8, Schedule B.

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QUESTIONS

KIND OF BUSINESS

1. By means of the key letters given below, identify the corporation's main income-producing activity with one of the general classes, and follow this by a special description of the business sufficient to give the information called for under each general class.

A.—Agriculture and related industries, including fishing, logging, ice harvesting, etc., and also the leasing of such property. State the product or products. B.—Mining and quarrying, including gas and oil wells, and also the leasing of such property. State the product or products. C.—Manufacturing. State the product and also the material if not implied by the name of the product. D.—Construction—excavations, buildings, bridges, railroads, ships, etc., also equipping and installing same with systems, devices, or machinery, without their manufacture. State nature of structures built, materials used, or kind of installations. E1.—Transportation—rail, water, local, etc. State the kind and special product transported, if any. E2.—Public utilities—gas (natural, coal, or water); electric light or power (hydro or steam generated); heating (steam or hot water); telephone; waterworks or power. E3.—Storage—without trading or profit from sales—(elevators, warehouses, stockyards, etc.). State product stored. E4.—Leasing transportation or utilities. State kind of property. F.—Trading in goods bought and not produced by the trading concern. State manner of trade, whether wholesale, retail, or commission, and product handled. Sales with storage with profit primarily from sales. G.—Service—domestic, including hotels, restaurants, etc.; amusements; other professional, personal, or technical service. State the service. H.—Finance, including banking, real estate, insurance. I.—Concerns not falling in above classes (a) because of combining several of them with no predominant business, or (b) for other reasons.

2. Concerns whose business involves activity falling in two or more of the above general classes, where the same product is concerned, should report business as identified with but one of the above general classes; for example, concerns in A or B which also transport and market their own product exclusively or mainly should still be identified with classes A or B; concerns in C (manufacturing) which own or control their source of material supply in A or B and which also transport, sell, or install their own product exclusively or mainly should be identified with manufacturing; concerns in D may control or own source of supply of materials used exclusively or mainly in their con-

structive work; concerns in E1 or E2 may own or control the source of their material or power; concerns in F may transport or store their own merchandise, but its production would identify them with A, B, or C.

3. Answers:

(a) General class (use key letter designation) D.

(b) Main income-producing business (give specifically the information called for under each key letter, also whether acting as principal or as agent on commission; state if inactive or in liquidation): Maintenances, repairs, and construction of railroads, barge canals, piers—shipways, dredging, etc.—acts as principal.

OTHER CORPORATIONS IN SAME BUSINESS

4. Enter on the following lines the names and adresses of five representative corporations in your locality or section of the country engaged in the same kind of business:

Great Lakes Dredge & Dock Co.
Walsh Construction Co.
Snare & Triest.
McLean Contracting Co.
Frederick L. Cranford, Inc.

INCORPORATION

5. Date of incorporation: April 12, 1911.

6. Under the laws of what State or country: New York.

REORGANIZATION AND ACQUISITION OF MIXED AGGREGATES OF ASSETS

7. Has the corporation, or any of its predecessors, been reorganized, or has it, or any of its predecessors, taken over a going business or acquired a mixed aggregate of tangible and intangible property, and paid for such property in whole or in part with stock or other securities since the close of the preceding taxable period?

8. If so, furnish a brief narrative history of the business and submit a statement showing:

(a) The name of the concern taken over (or from which the property was acquired);

(b) The nature of the assets and liabilities so acquired;

(c) The total par value of the stock issued therefor;

(d) The value at which each class of assets was carried on the books of the concern from which acquired (submit a balance sheet of the predecessor concern as at the date of acquisition or as at the close of its last accounting period prior thereto);

(e) The value at which each item was carried on the books of the corporation making this return, and full details of any adjustments subsequently made pertaining thereto and the basis on which such revaluation was made.

9. If patents, copyrights, secret processes or formulæ, good will, trade-marks, trade brands, franchises, or other intangible property were acquired, state the basis on which their value was determined and how they were paid for.

10. If at the time of any purchase or reorganization, as contemplated in question 7, any property was entered on the books of the reorganized concern or any vendee predecessor at a value in excess of that at which it was carried on the books of the vendor concern, state the basis on which the revaluation was made.

AFFILIATIONS WITH OTHER CORPORATIONS (TO BE ANSWERED BY EVERY CORPORATION)

11. Does the corporation own directly or control through closely affiliated interests or by a nominee or nominees over 70 per cent of the outstanding voting capital stock of another corporation or of other corporations? (Schedule attached.)

12. Is over 70 per cent of your outstanding voting capital stock owned by another corporation or by two or more corporations that are affiliated? No.

13. Is over 70 per cent of your outstanding voting capital stock as well as over 70 per cent of the outstanding voting capital stock of another corporation

or of other corporations owned or controlled by the same individual or partnership or by the same individuals or partnerships? No.

14. If the answer to questions 11, 12, and 13, or to any of them, is "yes," answer the following:

(a) Did the corporation file Affiliated Corporations Questionnaire, Form 819, for 1917 or subsequent taxable years? Yes. If the answer to this question is "yes," a questionnaire is not required, except under the circumstances described in question (b). If the answer to this question is "no," and the answers to questions 11, 12, and 13, or to any of them, is "yes," procure from the collector of internal revenue for your district Form 819, which shall be filled out and filed as a part of this return. If the answer to this question is "no," question (b) need not be answered.

(b) Did substantially the same conditions as are set out in the questionnaire filed for 1920 or prior years obtained during the entire taxable period 1921? Yes. If the answer to this question is "no," a statement, setting forth the particulars in which the situation has changed, should be attached to and made a part of this return. If there have been substantial changes in stockholdings, a complete schedule of such changes should be submitted in the form prescribed in Tables 3 and 6 of the questionnaire. If there are companies other than those covered by the questionnaire for 1920 or prior years which, applying the tests contained in questions 11, 12, or 13, may have come into the affiliated group since 1920, a questionnaire, Form 819, is required for the entire group for the taxable period.

VALUATION OF CAPITAL STOCK

15. What was the fair value of the total capital stock of the corporation as determined in the last assessment, if any, of the capital stock tax? $_____ Date of that assessment. (Schedule attached.)

PREDECESSOR BUSINESS

16. Did the corporation file a return under the same name for the preceding taxable period? _____ If not, was the corporation in any way an outgrowth, result, continuation, or reorganization of a business or businesses in existence during this or the preceding taxable period? Yes. If answer is "yes," give name and address of each predecessor business.

_____

_____

BASIS OF RETURN

17. Is this return made on the basis of actual receipts and disbursements? No. If not, describe fully what other basis or method was used in computing net income. Double-entry accrual (completed contracts).

GOVERNMENT CONTRACTS

18. Have any adjustments been made during the taxable period on account of contract or contracts with the Government or its agencies or in any Government contract or contracts from which the corporation derived income directly or indirectly, through the operations of a claim board or otherwise? No. If the answer to this question is "yes," state the amounts involved $X; whether or not such amounts are included in this return X; and, if not, was an amended return, accounting for the additional income, filed for the taxable period in which the contract was terminated? _____ Submit a schedule showing full particulars of the contract, date entered into, date the work ceased under said contract or contracts, and the amount and nature of the adjustment.

AMORTIZATION

19. Has amortization been claimed? No. If the answer to this question is "yes," state for what year X. Amount $X.

LIST OF ATTACHED SCHEDULES

Enter below a list of all schedules accompanying this return, giving for each a brief title and the schedule number:

Schedule A– 3: Gross income from operations.
A– 5: Taxable interest from other sources.
A–12: Expense.
A–10: Gross income from all other sources.
A–13: Compensation of officers.
A–16: Taxes.
A–18: Exhaustion, wear and tear.
A–23: Profit or loss on sales of capital assets and miscellaneous investments.
K: Balance sheets.
L (F–1). Adjustment of accrued interest on the Kerbaugh-Empire Company's foreign loan for years 1916 to 1920, inclusive, $183,127.31.
L (4–a). Interest on Bellwood Engineering Co., Inc., foreign loan for year 1921, $20,899.94.
Page 3, question 15: Valuation of cap. stk.
Page 3, question 11: Stock ownership.

SCHEDULE K.—BALANCE SHEETS. (Schedule attached)

Attach hereto balance sheets as at the beginning and end of the taxable period (preferably in parallel columns), showing as nearly as practicable the details called for below. (These balance sheets should be prepared from the books and should be in agreement therewith, or any differences should be reconciled, and if this is a consolidated return, balance sheets should be furnished in accordance with paragraph 7 of page 1 of instructions.)

ASSETS

Cash (including cash in bank and on hand, certificates of deposit, etc.)
Trade accounts (before deducting reserves for losses).
Notes receivable from customers.
Other accounts and notes receivable (to be classified).
Inventories:
Raw materials.
Work in progress.
Finished products.
Supplies.
Investments:
Bonds—
U. S. bonds and obligations (each issue to be stated separately).
Exempt (municipal, State, etc.).
Other.
Stock of corporations—
Foreign.
Domestic.
Loans and advances:
To officers and employees.
To others.
Deferred charges to future operations (to be detailed).
Fixed assets:
Land.
Buildings.
Machinery.
Tools and minor equipment.
Delivery equipment.
Office furniture.
Other (state character).
Less reserves for depreciation (show separately amount applicable to each fixed asset).*
Net value.
Patents, good will, and other intangible assets:
Paid for in cash or other tangible property.
Paid for in stock (other than stock dividends).
Created by stock dividend or otherwise.
Discount:
On bonds.
On stock.
Total.

LIABILITIES

Notes payable:
To officers and stockholders.
To others (including bank loans).
Accounts payable:
Trade.
Other.
Accrued expenses and reserves, the charges creating which are allowable deductions from income (to be detailed).
Reserves, the charges creating which are not allowable deductions from income:
Reserves for losses on notes and accounts receivable.
Other reserves (to be detailed).
Capital stock outstanding (to be classified).
Surplus and undivided profits.
Total.

All corporations engaged in an interstate and intrastate trade or business and reporting to the Interstate Commerce Commission and to any national,

* Reserves for depreciation may be deducted from the respective asset accounts or itemized on the liability side of the balance sheet.

State, municipal, or other public officer may submit in lieu of above form copies of their balance sheets prescribed by said commission or State and municipal authorities as at the beginning and end of the taxable period.

SCHEDULE L.—RECONCILIATION OF NET INCOME AND ANALYSIS OF CHANGES IN SURPLUS

1. Net income from Schedule A, item 27	$103, 201. 41
2. Nontaxable income:	
(a) Interest on obligations of the United States and its possessions exempt	57, 642. 06
(b) Interest on obligations of States, Territories, and political subdivisions thereof	766. 66
(c) Interest on farm loan bonds issued under Federal farm loan act	
(d) Dividends deductible under Section 234 (a) 6 of the revenue act of 1921	
(e) Dividends on stock of personal service corporations out of earnings upon which a Federal income tax has been imposed	
(f) Other items of nontaxable income (to be detailed):	
(1) (Schedule attached)	183, 127. 31
(2)	
(3) Return of Federal income taxes	3, 760. 36
3. Charges against reserves for bad debts, if item 17, Schedule A, is not an addition to a reserve	
4. Charges against reserves for contingencies, etc. (to be detailed):	
(a) (Schedule attached)	20, 899. 94
(b)	
(c)	
5. Total of items 1 to 4, inclusive	369, 397. 74
6. Total from item 14	10, 790. 60
7. Net profit for year as shown by books, before any adjustments are made therein (item 5 minus item 6)	358, 607. 14
8. Deficit as shown by balance sheet at close of preceding taxable period	2, 458, 652. 84
9. Other credits to surplus (to be detailed):	
(a)	
(b)	
(c)	
10. Total of items 7 to 9, inclusive (loss)	2, 100, 045. 70
11. Total from item 17	
12. Deficit as shown by balance sheet at close of taxable period (item 10 minus item 11)	2, 100, 045. 70
13. Unallowable deductions:	
(a) Donations, gratuities, and contributions	820. 75
(b) Income and profits taxes paid to the United States, its possessions, or foreign countries	
(c) Special improvement taxes tending to increase the value of the property assessed	
(d) Furniture and fixtures, additions, or betterments treated as expenses on the books	
(e) Replacements and renewals	
(f) Insurance premiums paid on the life of any officer or employee where the corporation is directly or indirectly a beneficiary	
(g) Interest on indebtedness incurred or continued to purchase or carry obligations or securities of the United States, the interest upon which is wholly exempt from taxation, except interest incurred to purchase or carry Victory 3¾% notes, originally subscribed for by the taxpayer	

13. Unallowable deductions—Continued.
    (h) Additions to reserves for bad debts which are not included in item 17, Schedule A
    (i) Additions to sinking fund reserve, and reserves for bad debts and other contingencies (to be detailed):
        (1)
        (2)
        (3)
    (j) Other unallowable deductions (to be detailed):
        (1) Self-insurance reserve 9, 969. 85
        (2)
        (3)

14. Total of item 13 10, 790. 60

15. Dividends paid during the taxable period (state whether paid in cash, stock of this company, or other property):
    (a) Date paid Character
    (b) Date paid Character
    (c) Date paid Character
    (d) Date paid Character
16. Other debts to surplus (to be detailed):
    (a)
    (b)
    (c)

17. Total of items 15 and 16

SCHEDULES TO BE FURNISHED IN SUPPORT OF ITEMS IN SCHEDULE A

The following schedules must be furnished, and those prepared on separate sheets should be firmly attached to this return. Enter name and address of corporation on each sheet.

Schedule A2: Cost of goods sold, exclusive of items called for separately.

If engaged in a trade or business in which the production, purchase, or sale of merchandise of any kind is an income-producing factor. (a) secure from the collector of internal revenue and file as a part of this return, Certificate of Inventory, Form 1126, and (b) fill in the following schedule, entering on lines 3 and 5 immediately before the amount column the letters "C," or "C or M," to indicate that inventories are valued at either cost, or cost or market, whichever is lower:

(1) Merchandise bought for sale $
(2) Cost of manufacturing or otherwise producing goods. (Submit schedule showing principal items of cost, the minor items being grouped in one amount.)
(3) Plus inventory at beginning of year
(4) Total
(5) Less inventory at end of year
(6) Cost of goods sold

Schedule A3: Gross income from operations other than trading or manufacturing. (Schedule attached.)

Submit a schedule showing the nature and amount of the principal items included herein, the minor items being grouped in one amount. (For insurance companies see page 2 of instructions, paragraphs 2 and 7.)

Schedule A4: Taxable interest on liberty bonds, etc.

The interest on the obligations listed in column 1 of the following table is wholly exempt from corporation income tax, and is exempt from excess-profits tax only to the extent that the aggregate principal amounts do not exceed the exemptions specified in columns 2, 3, and 4.

In case the obligations held exceed these exemptions, the principal amounts in excess thereof should be entered in column 5, and the taxable interest thereon in column 6. If these securities were bought and sold during the taxable period, attach a statement showing the holdings by periods.

If this is a consolidated return, each corporation composing the affiliated group is entitled to the full amount of these exemptions.

1. Obligations	Exemptions (aggregate principal amount)			5. Principal amount in excess of exemptions specified in columns 2, 3, and 4	6. Interest on principal amount in excess of exemptions
	2. $30,000	3. $125,000	4. $5,000		
(a) First Liberty loan second converted 4¼% bonds					
(b) First and second 4's, and first, second, third, and fourth 4¼'s	None.				
(c) Other obligations issued since September 1, 1917 (except Victory and Treasury notes)	None.	None.			
(d) Victory Libery loan 4¾% notes, and Treasury notes	None.	None.	None.		
Total taxable interest					$

Schedule A10: Gross income from all other sources (not including any amount with respect to sale of capital assets or miscellaneous investments).

Submit a schedule showing the source, nature, and amount of the principal items included herein, the minor items being grouped in one amount. The total of the schedule should be entered as item 10, Schedule A.

Schedule A12: Expenses (except amounts called for separately in Schedule A).

Submit a statement showing character and amount of the principal items included herein, the minor items being grouped in one amount. (For schedules to be submitted by insurance companies see page 2 of instructions, paragraphs 3 to 7.) (Schedule attached.)

Schedule A13: Compensation of officers. (Schedule attached.)

Submit a schedule showing for each officer (1) name, (2) duties, (3) time devoted to such duties, (4) shares of stock owned or controlled: (a) preferred, (b) common; (5) total compensation for the taxable period, and (6) amount of, and reason for increase, if any, over preceding period.

Schedule A14: Repairs (including labor, supplies, overhead, and other items properly chargeable to repairs).

Submit a schedule showing the nature and amount of the principal items included herein, the minor items being grouped in one amount. (For classification of repairs see page 2 of instructions, paragraph 8.)

Schedule A16: Taxes. (Schedule attached.)

Submit a schedule showing separately for each class of taxes deducted, (a) character, and (b) amount.

Federal income and profits taxes which are a credit under section 238, taxes assessed against local benefits of a kind tending to increase the value of the property assessed are not allowable deductions. (See sections 234 (a) 3 of the revenue act of 1921.)

Schedule A17: Bad Debts.

Submit a schedule showing debts or portions thereof, arising from sales or professional services that have been reported as income, which have been definitely ascertained to be worthless and charged off within the year, or such reasonable amount as has been added to a reserve for bad debts within the year.

If the amount entered as item 17, Schedule A, is an addition to a reserve, furnish proof of the reasonableness of the amount. (See section 234 (a) 5 of the revenue act of 1921.)

Schedule A18: Exhaustion, wear and tear (including obsolescence).

If a deduction is made on account of depreciation, the following schedule must be filled in, and the total amount claimed therein should correspond with the figures reflected in the balance sheet. Land values must not be included in this schedule. (See page 2 of Instructions, paragraph 10, and section 234 (a) 7 of the revenue act of 1921.) (Schedule attached.)

Kind of property (If buildings, state the material of which constructed)	Date acquired	Age when acquired	Probable life after acquirement	Cost, or if acquired prior to Mar. 1, 1913, the fair market value on that date	Amount of depreciation charged off	
					This year	*Previous years*
				$	$	$
Total				$	$	$

NOTE.—If obsolescence is a factor in determining your deduction attach a statement showing the amount claimed for the taxable period and the basis on which computed.

Schedule A19: Depletion.

If a deduction is claimed on account of depletion, secure from the collector Form D (minerals), Form E (coal), Form F (miscellaneous nonmetals), Form O (oil and gas), or Form T (timber), fill in and file with return. If complete valuation data has been filed with questionnaire in previous years, then file with this return information necessary to bring your depletion schedule up to date, setting forth in full statement of all transactions bearing on deductions or additions to value of physical assets with explanation of how depletion deduction for taxable period has been determined. In case of timber this should be done by filling in Form T (timber).

Schedule A20: Amortization of war facilities.

In case a deduction is claimed on account of amortization, a schedule should be submitted containing the information called for in Guide Form 1007 M, which explains in detail the manner in which a claim of this nature should be presented. A copy of this form may be obtained from the Commissioner. (See section 214 (a) 9 of the revenue act of 1921).

Schedule A23: Profit or loss on sales of capital assets and miscellaneous investments. (Schedule attached.)

In case of disposal of property, resulting in a profit or loss, a schedule in the following form must be furnished, using a separate line for each asset. (See sections 202, 234 (a) 4, and 234 (a) 14 of the revenue act of 1921.)

1. Kind of property	2. Date acquired	3. Sale price	4. Cost	5. Fair market value on Mar. 1, 1913, if acquired prior to that date	6. Cost of subsequent improvements	7. Depreciation	8. Net profit (or loss)
		$	$	$	$	$	$
Total							$

State what amount, if any, included in column 5, represents good will, $_____

If any of the assets were acquired prior to March 1, 1913, state how the fair market value on that date was determined _____

In case of exchange of property, submit evidence substantiating the basis used in arriving at the market value of property received _____

_____

Schedule A24: Losses by fire, storm, etc.

A schedule similar to the one requested above should be submitted with respect to losses of property arising from fires, storms, shipwreck, or other casualty, or from theft, and not compensated for by insurance or otherwise, except that column 3 should show "Insurance and salvage" instead of "Sale price."

Schedule A26: Dividends (deductible under section 234 (a) 6 of the revenue act of 1921).

Submit a schedule showing the amount received as dividends (a) from each domestic corporation other than a corporation entitled *to the benefits of section* 262 of the act, or (b) from each foreign corporation when it is shown to the satisfaction of the Commissioner that more than 50 per centum of the gross income of such foreign corporation for the three-year period ending with the close of its taxable year preceding the declaration of such dividends (or for such part of such period as the foreign corporation has been in existence) was derived from sources within the United States as determined under section 217 of the act.

Discount and premium on bonds sold.

There must be attached to the return a schedule showing in detail each issue and sale of bonds of the reporting corporation giving the following information: (a) Class; (b) date of sale; (c) maturity; (d) amount sold; (e) amount realized; (f) premium or discount per annum.

That proportion of the premium or discount applicable to the return period must be reported either as item 10 or 15, schedule A, page 1, unless the amount of premiums or discount has been reported as income or allowed as a deduction in prior years.

We, the undersigned, president and treasurer of the corporation for which this return is made, being severally duly sworn, each for himself deposes and says that this return, including the accompanying schedules and statements, has been examined by him and is, to the best of his knowledge and belief, a true and complete return made in good faith, for the taxable period as stated, pursuant to the revenue act of 1921 and the regulations issued under authority thereof.

(Orig. return sgd. by) J. H. McClement,
President.

(Orig. return sgd. by) C. A. Nicklas,
Treasurer.

Sworn to and subscribed before me this 13th day of June, 1922.

[Seal of officer making affidavit.] M. F. Boylan,
Notary Public.

46 *Exhibit II to complaint*

Schedule A–10: Gross income from all other sources

The amount as returned under this item is reported solely because of a ruling of the Commissioner of Internal Revenue, a copy of which ruling is hereto attached.

Taxpayer hereby enters its protest against the returning of the sum of $684,456.18 as a part of the amount of this item as "income" of any character, and furthermore protests against the assessment of any tax whatsoever because of its inclusion in the return and the payment of tax based upon such inclusion. Taxpayer now pays under protest the sum of $5,198.77, being two one-fourth payments of $2,580.03½ each of the tax to be assessed because of the involuntary reporting of this item with interest.

1. The amount here reported, namely, $684,456.18, is not income under the Constitution of the United States, nor is it income, profits,

or gains under the law, and therefore the commissioner has no authority in law to require the amount to be returned or to assess or demand payment of any tax based thereon.

2. If in any respect the amount involved under the item, namely, $684,456.18, can be held to be income, profits, or gains, nevertheless, the Commissioner of Internal Revenue is without lawful authority to assess or to collect any tax based thereon, because the amount returned was not received within the year 1921 nor was the greater portion of it received after March 1, 1913.

3. If in any respect the amount involved, namely, $684,456.18, can be held to be income, profits, or gains, nevertheless the Commissioner of Internal Revenue is without lawful authority to assess or collect any tax based on the full amount thereof, because the greater part of said amount was not received subsequent to March 1, 1913.

4. The amount of $684,456.18 as reported is not income, profits, or gains, because the amounts borrowed by the taxpayer as hereinafter referred to and which constitute the basis of the amount of the item were immediately invested in legitimate contracting operations carried on by the taxpayer and its subsidiaries, and the amounts so invested were actually lost in such contracting operations.

5. The amount of $684,456.18 as returned is not income, profits, or gains and is not subject to the assessment or demand of payment of tax based thereon for the reason that the repayment of the loans, which repayment constitutes the basis of the ruling of the commissioner, was made as a settlement, adjustment, and compromise of claim made by an officer or department of the United States of America, to wit, the Alien Property Custodian.

47 In general, the facts of the transaction out of which the amount reported under this item arose, are these:

The Kerbaugh-Empire Company is a holding company whose subsidiaries are and have been engaged in general construction work. In 1911 the Kerbaugh-Empire Company entered into negotiations with the Deutsche Bank through its New York representative for the loan of various amounts, the advances to be used in general construction work carried on by its subsidiaries. After an exchange of cables, the Deutsche Bank agreed to extend a line of credit to the Kerbaugh-Empire Company, but would only accept notes made payable in German marks. The company objected to the transaction being in marks, but inasmuch as the bank would only accept notes so drawn the officers of the company acquiesced. The loans were made in accordance with the following procedure:

1. The company would advise Mr. Adams, the representative of the bank, of its needs.

2. Mr. Adams would cable the bank at Berlin.

3. The Deutsche Bank would, by cable transfer, credit Mr. Adams in some banking institution in New York with a certain number of marks equivalent to the number of dollars needed by the company.

4. Mr. Adams upon receipt of this credit would draw his check against the sum and hand it to the company.

5. In exchange for this check the company would turn over to Mr. Adams its promissory note payable in equivalent marks.

6. These notes were turned over to Mr. Adams as the American representative of the Deutsche Bank and he held them for the bank's account.

7. The interest on the notes was payable in marks the same as the principal. On the dates when the interest was due Mr. Adams determined the prevailing rate of exchange and the company handed him its check in dollars to his order for the number of marks due.

Between June, 1911, and July, 1913, the Deutsche Bank had advanced to the Kerbaugh-Empire Company 8,431,337.50 marks and the Kerbaugh-Empire Company had repaid to the Deutsche Bank the sum of 5,124,892.50 marks. The rates of exchange at which the advances were received netted the borrower about 24 cents
48 per mark. The balance of principal due the Deutsche Bank was 3,216,445 marks, represented by one note. No loans were made after this, and this note was outstanding when the United States entered the war. The equivalent of this amount in round numbers was about $765,000, at pre-war rates of exchange. After the United States entered the war the Kerbaugh-Empire Company was requested to report to the Alien Property Custodian any funds it might have belonging to the Deutsche Bank, and on December 3, 1917, the company reported the situation with reference to the line of credit afforded it by the bank. Inasmuch as the note was a demand note, the Alien Property Custodian demanded that the Kerbaugh-Empire Company pay over to him the amount of the note and interest, although it was explained to the Alien Property Custodian that the understanding between the bank and the company at the time the note was made that it would not be demanded until it was entirely convenient for the company to pay it. Negotiations were entered into with the Alien Property Custodian with a view to liquidating the claim which the Alien Property Custodian might have with refereñce to the matter. It was discovered that the Alien Property Custodian did not have the note and did not know where the note was. Nevertheless he demanded that the indebtedness be settled and threatened to bring suit against the company unless settlement was made. After considerable dispute the matter was finally compromised, and the company, under protest, paid the Alien Property Custodian $113,688.23 in full settlement of the dispute and of all claims of the Alien Property Custodian to the 3,216,445 marks and the interest due the Deutsche Bank, the rate of exchange used in determining the dollar equivalent of the marks at the time of such settlement and on which the settlement was based was in excess of the then prevailing current rate of exchange. This payment was made in 1921, and the Alien Prop-

erty Custodian accepted the said sum in full settlement of the "dispute as to the amount due on said note, and in full satisfaction of all the aforesaid demands made by the Alien Property Custodian in the premises," as shown in the release given to the company by the Alien Property Custodian. Of the above mentioned payment of $113,688.23, $80,411.12 represents settlement of principal and $33,277.11 represents settlement of interest.

49, 50, 51 [Omitted.]

52 *Exhibit I to complaint*

Claim for

- ☐ Abatement of tax assessed.
- ☐ Credit against outstanding assessments.
- ☐ Refund of taxes illegally collected.
- ☐ Refund of amounts paid for stamps used in error or excess.

Notice to collector: Collector must indicate in block above the kind of claim, except in income-tax cases.

STATE OF NEW YORK,
County of New York, ss:

Name of taxpayer or purchaser of stamps: The Kerbaugh-Empire Company & subsidiaries, viz., Bellwood Engineering Company, Inc., & Interlake Engineering Co., Inc.

Residence—give street and number as well as city or town and State: 6 Church Street, New York City.

This deponent, being duly sworn according to law, deposes and says that this statement is made on behalf of the taxpayer named, and that the facts given below with reference to said statement are true and complete:

1.	Business in which engaged: Contractors—engineers.	
2.	Character of assessment or tax: Income & profits tax for year 1921, with int.	
3.	Amount of assessment or stamps purchased: X.	
4.	Reduction of tax liability requested (income and profits tax) with interest and/or refunded if paid prior to decision on this refund claim	$10,358.84
5.	Amounts to be abated—third & fourth payments due Sept. 15 & Dec. 15, 1922	85,160.07
6.	Amount to be refunded (or such greater amount as is legally refundable)	85,198.77
7.	Dates of payment (see collector's receipts) June 13, 1922. (If statement covers income tax liability, items 8–11, inclusive, must be answered.)	
8.	District in which return (if any) was filed: Second District, New York.	
9.	District in which unpaid assessment appears: Second District, New York.	
10.	Amount of overpayment claimed as credit: None.	
11.	Unpaid assessment against which credit is asked; period from X to X.	

Deponent verily believes that this application should be allowed for the following reasons: As stated in protest and Schedule A–10 of the company's income and profits tax return for the calendar year 1921, a copy of which is annexed hereto.

Signed: J. H. McCLEMENT,
President.
C. A. NICKLAS,
Secretary & Treasurer.

Sworn to and subscribed before me this 13th day of June, 1922.

M. F. BOYLAN,
Notary Public.

53 CERTIFICATES

Schedule No. ----------.

I certify that an examination of the records of the Bureau of Internal Revenue shows the following facts as to the assessment and payment of the tax:

Name of taxpayer	Character of assessment and period covered	List	Year	Month	Page	Line	Amount	Date paid	District in which paid
							$		

----------,
Collector of Internal Revenue.

----------,
Assessment Clerk, Commissioner's Office.

54014—25——4

Claim No.....

I certify that the records of my office show the following facts as to the purchase of stamps:

To whom sold or issued	Kind	Number	Denomination	Date of sale or issue	Amount	If special tax stamp, state:	
						Serial number	Period commencing—
.....	.....	.....	.....	.....	$.....	.....	.....
.....	.....	.....	.....	.....	.....	.....	.....
.....	.....	.....	.....	.....	.....	.....	.....
.....	.....	.....	.....	.....	.....	.....	.....
.....	.....	.....	.....	.....	.....	.....	.....

.....,

Collector ..... *District* .....

Schedule number ..... District .....

Allowed or rejected number ....

(Nature of tax)

Claimant .....

Address .....

Examined and submitted for action ....., 19....

Committee on claims

Amount claimed.... $..... .....

Amount allowed.... $..... .....

Amount rejected.... $..... .....

54 *Exhibit J to complaint*

TREASURY DEPARTMENT,
Washington, June 15, 1922.

Office of Commissioner of Internal Revenue

Address reply to Commissioner of Internal Revenue and refer to:

KERBAUGH-EMPIRE COMPANY & SUBSIDIARIES,
% Mr. Harvey D. Jacob, Woodward Building,
Washington, D. C.

GENTLEMEN: Reference is made to your claim for refund in the amount of $5,198.77, filed under date of June 13, 1922.

The question presented in the claim was considered in office letter dated April 22, 1922, and for the reasons therein stated the claim is hereby rejected in its entirety.

Yours very truly,

D. H. BLAIR,
Commissioner.

B.

[File indorsement omitted.]

55 United States District Court

[Title omitted.]

Opinion filed April 19, 1924

Kellogg & Rose, attorneys for plaintiff; Franklin Novius, Harvey D. Jacob, of counsel.

William Hayward, United States attorney; Victor House, special assistant United States attorney; Nelson T. Hartson, Solicitor of Internal Revenue; Preston C. Alexander, special attorney, Bureau of Internal Revenue.

GODDARD, *District Judge:*

This action is brought by the plaintiff to recover the sum of $5,198.77 paid by plaintiff under protest on June 13th, 1922, as the first and second quarterly intsallments of corporation income tax for the calendar year 1921. The defendant has filed a motion to dismiss the amended complaint on the ground that it does not state facts sufficient to constitute a cause of action. The cause comes on for hearing on this motion. The essential allegations of the
56 amended complaint that are pertinent to the question involved in this motion are as follows:

Defendant, at all the times material, was the collector of the internal revenue for the Second District of New York; that plaintiff, a New York corporation, was the owner of all the stock of certain subsidiary corporations, including H. S. Kerbaugh, Inc., a Pennsylvania corporation, which on and prior to June 8th, 1911, was engaged in the performance of large construction contracts in connection with the building of the Kensico Dam in New York; that on that date, its subsidiary was in need of funds to finance its construction contracts, and in order to secure funds which it could advance to the subsidiary for that purpose applied to the Deutsche Bank of Berlin through its New York agent, one Edward D. Adams, to make the necessary advances. The bank agreed to extend the required credit, but only on condition that the notes therefor be made payable as to both principal and interest in German marks or their equivalent in United States gold coin at prime bankers' rate in the city of New York for cable transfer to Berlin. Commencing on June 8th, 1911, the loans were made in accordance with the following procedure:

That plaintiff would advise Mr. Adams of the amount of money needed in terms of dollars; the latter would cable to the bank in Berlin for an amount of marks equivalent to plaintiff's need in dollars. The bank would, by cable transfer, credit Mr. Adams
57 in some banking institution in New York with the number of marks equivalent to the number of dollars needed by plaintiff; that Mr. Adams, upon receipt of this credit, would draw his cheque against the sum payable in dollars, deliver it to the plaintiff, and upon its presentation by plaintiff to the bank against which it

was drawn the cheque would be paid to plaintiff in dollars; that in exchange for each cheque plaintiff would deliver to Mr. Adams its promissory note payable as to both principal and interest in reichsmarks. On the dates when the interest fell due Mr. Adams advised as to the prevailing rate of exchange and plaintiff handed him its cheque in dollars for the number of marks due.

Between June 8th, 1911, and July 2nd, 1913, loans were made to plaintiff in the manner above set out, the total amount of dollars actually received by plaintiff being $1,983,000, and the equivalent in terms of reichmarks at the prevailing rate of exchange at the time loans were made being 8,341,337.50.

Plaintiff made such payments on account of these loans that on September 1st, 1913, there remained unpaid 6,740,800 marks, and on the last-mentioned date its old notes were all surrendered and a new note given by it for this balance. On the due date of the renewal note it was surrendered and a new note given for the same amount; this new note read as follows:

"Rm. 6,740,800. MARCH 2, 1914.

"On April 1, 1915, for value received, the Kerbaugh-Empire
58 Company promises to pay to its own order six million seven hundred forty thousand eight hundred reichsmarks (Rm. 8,740,800), at its office in New York City, with interest at the German bank rate as it may be established from time to time, but at not less than 6% per annum and 1% commission per annum, payable June 1, 1914, and quarterly thereafter, both principal and interest being payable in German reichsmarks or their equivalent in United States gold coin at prime bankers rate in the City of New York for cable transfers to Berlin, Germany.

"THE KERBAUGH-EMPIRE COMPANY,
"By C. A. NICKLAS, *Treasurer.*

"Countersigned:
"M. A. HAUSCHILD,
"*Vice President.*"

After the execution and delivery of the latter note such payments were made on account of the principal thereof that by March 31st, 1915, the principal amount due thereon was reduced to 3,216,445 marks.

All the funds borrowed by the plaintiff from the Deutsche Bank were loaned by it to its subsidiary for use in financing its construction contracts. The carrying on by the subsidiary of its contracts resulted in its losing all the money so advanced to it. The subsidiary claimed and was allowed a loss of such amounts in its income tax returns for the years 1913, 1914, 1916, 1917, and 1918. The amount of such losses so largely exceeded any income accruing to the subsidiary in those years as to leave a large excess of losses over income, the total of this excess of losses being in excess of $684,456.10.

Of the balance of 3,216,445 marks remaining unpaid on
59 March 31st, 1915, only 1,892,000 marks were borrowed subsequent to March 1st, 1913.

After the United States entered the war the Alien Property Custodian called upon the plaintiff to pay over to him the amount of the note, the Deutsche Bank being an alien enemy. Negotiations were entered into between the plaintiff and the Alien Property Custodian with a view to liquidating the claim. After considerable dispute, the matter was finally adjusted and the company, under protest, paid to the Alien Property Custodian $113,688.23 in full settlement of both principal and interest. Of this sum $80 411.12 represented settlement of principal, and $33,277.11 represented interest. The rate of exchange in determining the dollar equivalent of the number of marks under the note was slightly above the prevailing current of exchange—about 2½¢ per mark. This settlement was reached and payment to the Alien Property Custodian made in 1921. The result of the transaction was that by reason of the fall in the value of the mark plaintiff was able to discharge the principal of its loan of approximately $770,000 by the payment of $80,411.12. The difference between the principal amount borrowed (approximately $770,000) and the amount paid in settlement of the principal $80,411.12) was $684,456.18.

The Commissioner of Internal Revenue treated this sum of $684,-
456.18 as income for the year 1921 and assessed against the
60 plaintiff the tax sought to be recovered in this suit. Without this item the plaintiff's income tax return for this year shows no taxable income, but, instead, a large deficit. The plaintiff paid the tax under duress and protest and filed its refund claim, which was rejected.

The statute

The pertinent provisions of the revenue act under which the commissioner claims are as follows:

Revenue act of 1921 (act of Congress approved November 23d, 1921, 42 Stat. 237–254):

"SEC. 230. That, in lieu of the tax imposed by section 230 of the revenue act of 1918, there shall be levied, collected, and paid for each taxable year upon the net income of every corporation a tax at the following rates:

"(a) For the calendar year 1921, 10 per centum of the amount of the net income in excess of the credits provided in section 236; * * *.

"SEC. 232. That in the case of a corporation subject to the tax imposed by section 230 the term 'net income' means the gross income as defined in section 233 less the deductions allowed by section 234. * * *.

"SEC. 233. (a) That in the case of a corporation subject to the tax imposed by section 230 the term 'gross income' means the gross income as defined in sections 213 and 217. * * *.

"SEC. 213. That for the purposes of this title (except as otherwise provided in section 233) the term 'gross income'—

"(a) Includes gains, profits, and income derived from * * * businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from * * * the transaction of any business carried on for gain or profit, or gains or profits, and income derived from any source whatever. The amount of all such items (* * *) shall be included in the gross income for the taxable year in which received by the taxpayer, * * *."

61 The question involved is whether a settlement with the Alien Property Custodian made in 1921 by paying to that official an amount in dollars, fixed after a dispute as to such amount to be paid to discharge a debt payable in marks, which had been loaned to plaintiff in the years 1911, 1912, and 1913, was, in fact, income to the plaintiff to the extent of the difference between the value of the marks as borrowed in the years 1911, 1912, and 1913 and the amount for which the corporation made such settlement with the Alien Property Custodian in the year 1921. That difference amounted to $684,456.18.

An examination of a copy of the plaintiff's consolidated corporation income and profits tax return for the year 1921, filed for itself and its subsidiaries, shows that were it not for the inclusion under Schedule A, item 10, of the item of $684,456.18 the company, instead of showing taxable income for the year 1921, would, on the contrary, show a loss of $581,254.77.

The plaintiff contends that on the statement of facts as set forth in the complaint, and as next hereinafter summarized, it was not required to pay income tax on any amount arrived at by including the item of $684,456.18, because—

First. That amount was not income realized by the plaintiff within the intent and meaning of the sixteenth amendment to the United States Constitution.

62 Second. Under the provisions of the revenue act of 1921, assuming, for the sake of argument, the power of Congress to tax gains and profits in addition to incomes, the amount of the items in question did not constitute either income, profit, or gain to the plaintiff; and

Third. Assuming, for the sake of argument, that the plaintiff did receive an income, profit, or gain, as defined in the revenue act of 1921, the sum of $684,456.18, that amount was received by the plaintiff during the years 1911, 1912, and 1913 and should not have been included as income received in the year 1921.

Does the item of $684,456.18 constitute income "from whatever source derived"? If the item was not income, then it does not come within the provisions of the sixteenth amendment, and any attempt to tax it under the revenue act of 1921 is unconstitutional. The sixteenth amendment to the United States Constitution is as follows:

"Taxes on incomes

"The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration."

The effect of the sixteenth amendment was not to grant power to Congress to tax incomes, because that power it always had. It was adopted to meet the decision of the United States Supreme Court in Pollock v. Farmers' Loan & Trust Co., 157 U. S.
63 429, that decision having declared the act of 1894 unconstitutional, not because Congress had no power to tax income, but because, so far as the act of 1894 operated to tax incomes derived from property, either real or personal, it was considered a direct tax which, under the provisions of Article I, section 2, clause 3, and Article I, section 9, clause 4, of the Constitution would require apportionment. This was clearly pointed out by the Supreme Court in the cases of Flint v. Stone Tracy Co., 230 U. S. 107; Brushaber v. Union Pacific Railroad Co., 240 U. S. Eisner v. Macomber, 252 U. S. 187, said: "Income may be defined as the gain derived from capital or labor, or from both combined, providing it be understood to include profit gained through a sale or conversion of capital assets." This definition has been reaffirmed in Merchants Loan & Trust Company v. Suietanka, 255 U. S. 509; United States v. Phellis, 257 U. S. 156.

The definition contains five elements:

1. Gain derived from capital.
2. Gain derived from labor.
3. Gain derived from capital and labor combined.
4. Profit gained through sale of capital assets.
5. Profit gained through conversion of capital assets.

The item involved in the case at bar was not derived from the use of capital; it was not derived from the use of labor; it was not a gain from the sale of capital assets, for there was no sale
64 of capital assets. The only possible element of the definition upon which the Internal Revenue Commissioner could have based the claim is therefore the element of gain from a conversion of capital assets. But there seems to have been no conversion of capital assets, for all that the plaintiff did was to pay a debt and thereby eliminate an item of liability. In view of the Supreme Court decisions, it appears that to constitute an income as a result of conversion of capital assets there must be in the hands of the taxpayer, as said in Eisner v. Macomber (supra), "something of exchangeable value proceeding from the property severed from the capital, however invested or employed, and coming in, being "derived," that is, received or drawn by the recipient (the taxpayer) for his separate use, benefit, and disposal; that is income derived from property. Nothing else answers the description."

Certainly there was no conversion of capital to bring the transaction in the case at bar within the intent of the five elements of the

definition, for the reason that the capital after the transaction was exactly what it was before. All that happened as a result of the transaction was the payment of a debt. There was nothing severed from the capital that came into the taxpayer within the intent of the Supreme Court's holding in the Eisner case. There was nothing that the taxpayer had that was derived, received, or drawn as an item or thing separated from the capital and that essential element of income resultant from the conversion of capital is nonexistent in the case at bar.

65 As has been forcibly stated by counsel for plaintiff, stripped of many of its complications, the situation presented here is about as follows:

A borrowed from B in 1911 the sum of $1,000. A immediately after borrowing that sum lost or spent it. In 1921 A, not having earned anything as the result of personal efforts or use of capital, had in his possession the sum of $100. With that $100 A approaches B and offers him the $100, which is all the money he has, if B will take it as a full settlement of the $1,000 indebtedness. B accepts it in full settlement of the indebtedness, and releases A. Has A any income within the meaning of the word "income" as used in the sixteenth amendment? If so, where is it and how or when did he receive it? If A, in the illustration, has no income, then clearly this plaintiff had no income in 1921 in the item of $684,456.18 and is entitled to judgment.

It can not be said that the use of the words "profit or gain," in addition to the word "income" in the internal revenue act of 1921, justifies the ruling of the Internal Revenue Commissioner, even though the item in question was not in fact income, for Eisner v. Macomber (supra) holds that the taxing power of Congress can not exceed the authority of the sixteenth amendment, or can it be contended that the tax in question can be sustained under the

66 act as claimed extension of the amendment, for then to the extent that the act exceeds the authority of the amendment it would be unconstitutional under Eisner v. Macomber. The Internal Revenue Commissioner apparently based his decision on the theory that although in ordinary operations "the borrowing of money and the payment of a loan is a capital transaction which ordinarily does not result in a taxable gain or deductible loss," nevertheless in this particular transaction the commissioner held that the rule that borrowing money and repaying loans is a capital transaction is changed because the bank insisted that when the plaintiff repaid the loan it should repay in marks or their equivalent in dollars. This ruling was based on an attempt to draw an analogy between the transaction of the case at bar and income which a dealer in foreign exchange might have resultant from the purchase and sale of the currency of a foreign nation. But this plaintiff was not dealing in foreign exchange. It paid its debt in dollars, although, for the purpose of calculating the amount of the settlement, that

ement was based on a rate of exchange in marks. In the case
r all that plaintiff did was to borrow money from a foreign
in the currency of the country in which the bank was located,
that money, and then, eight years later, pay its debt in dollars
e equivalent at the then value of marks. Nothing has been
ed from the plaintiff's capital as a result of this transaction
which has come into the plaintiff. The improvement of the
plaintiff's balance sheet is not income to the plaintiff. All
that it had was a decrease in liability. In Eisner v. Macomber
ra) it was held that "enrichment through increase in value
pital investment is not income in any proper meaning of the

the Smietanka and Phellis cases the Supreme Court held that
stock or property are sold income is realized to the extent of
ifference between the value of such stock or property at the
it was purchased and the amount realized on such sale. Those
follow within the definition of income as given in the Eisner
because they were based either on sale of capital assets, as in
Smietanka case, or a conversion of capital assets, as in the
is case.

the case at bar there was no sale of capital assets, nor was
any such conversion of capital assets as existed in the Phellis
On the Government's theory all that the plaintiff could have
s an accretion of assets. As a matter of fact, there was not
an increase of assets. There was a decrease of assets through
ayment of a part of plaintiff's assets in settling the indebted-
The fact that after the transaction the plaintiff's balance
had improved was not sufficient to constitute "a gain derived
from capital." If anything, it was a gain accruing to capital,
and as such, under the Eisner and Phellis cases, was not tax-
able income.

we were to assume that Congress had power to enlarge as done
tion 213 of the revenue act of 1921, there is nothing in this
n that justifies the Internal Revenue Commissioner including
tem of $684,458.18 in the gross income, or that an income tax
d be based on such item.

e pertinent provision of the revenue act of 1921 is section 213,
reads as follows:

hat for the purposes of this title (except as otherwise provided
tion 233) the term 'gross income'—
) Includes gains, profits, and income derived from salaries,
, or compensation for personal services * * * of whatever
and in whatever form paid, or from professions, vocations,
s, businesses, commerce, or sales, or dealings in property,
ner real or personal, growing out of the ownership or use of
terest in such property; also from interest, rent, dividends,
ties, or the transaction of any business carried on for gain or
or gains or profits and income derived from any source what-

The provisions of section 213 are obviously broader than the language of the sixteenth amendment.

The item was not income; that leaves for consideration only the two elements—was it gain or was it profit? It seems clear that under the revenue act the intent was to tax only gains or profits resultant from the employment of capital. We can eliminate the theory
69 that it was a gain or profit, through dealing in foreign exchange. That then leaves the proposition that if at the end of any taxable year the balance sheet of a taxpayer shows a greater difference between assets and liabilities than it did at the end of the preceding taxable year, the excess of difference is taxable as such. However, that leaves out of consideration the essential element to make such a difference taxable income, which is the necessity that it shall be derived from the employment of capital or labor or from the sale or conversion of capital assets resulting in a profit from such sale or conversion.

The plaintiff paid a debt in 1921 for a lesser amount in dollars that it had secured through borrowing amounts in marks in 1911, 1912, and 1913. It is equivalent to a release of obligation to that extent. If the debt had been released in full, there could have been no taxable claim made that the plaintiff gained income to the extent of the amount of the debt. For the Circuit Court of Appeals in the United States v. Oregon-Washington Railroad & Navigation Co., 251 Fed. 211, held that where an indebtedness of a corporation was canceled the amount of the indebtedness so canceled did not and could not constitute income. In the opinion in that case it stated, at page 213:

"Now, it seems to us hardly arguable that the cancellation of the debt in question was not in the category of capital. The corporation had just commenced its business; the cancellation of the
70 debt was a means of contribution to its capital account quite as though the money had been contributed by the stockholder only to enhance the value of his stock. The financial relief so given will, it is true, be eventually reflected in the income, since the defendant will no longer be entitled under the act to deduct the interest on the debt; but that only brings out more clearly its character as capital contribution. We regard the difference as precisely equivalent to the difference between the cancellation of a portion of the mortgage bonds and a cancellation of an equal proportion of their coupons. Common usage would, if we are right, unfailingly allocate the first as an increase in capital assets and the second as an increase in income. That, as we view it, is the proper test of the act."

The Oregon case arose under the corporation excise tax act, but that act was an excise tax based on the income of the corporation and required a definition of the word "income."

In Southern Pacific Co. v. Lowe, 247 U. S. 330, it was held that the word "income" which was applicable under the excise tax act

will be applied in construing the term "income" under the income tax act. It seems clear that neither the sixteenth amendment nor the revenue act sought to levy an income tax upon anything except income as it was actually received; and under the Constitution and the revenue act of 1921 there can be no such thing as a negative income, the two words being inconsistent.

The defendant's motion for judgment on the pleadings is denied, and a decree may be entered in favor of the plaintiff.

HENRY W. GODDARD,
U. S. D. J.

April 18th, 1924.

71 In United States District Court

Order denying motion to dismiss

Filed May 6, 1924

[Title omitted.]

The defendant above named having duly moved for an order granting judgment dismissing the amended complaint herein upon the ground that it appeared upon the face thereof that the said amended complaint did not state facts sufficient to constitute a cause of action, and the said motion having come on to be heard before me, now after hearing Victor House, Esq., assistant U. S. attorney, Nelson Hartson, Esq., Solicitor of Internal Revenue, and Preston C. Alexander, Esq., special attorney, Bureau of Internal Revenue, in support of said motion, and Messrs. Kellogg & Rose, Franklin, Nevius, and Harvey D. Jacob, Esq., of counsel, in opposition thereto, and due deliberation having been had thereon,

72 Now, on motion of Kellogg & Rose, attorneys for the plaintiff, it is hereby

Ordered, that said motion be, and the same is hereby, denied and that final judgment be entered in favor of the plaintiff, Kerbaugh-Empire Company, as demanded in the complaint.

HENRY W. GODDARD,
U. S. D. J.

[Title indorsement omitted.]

73 In United States district court

[Title omitted.]

Judgment

Filed May 20, 1924

Upon the order of this court, duly made and entered on the 6th day of May, 1924, which order, among other things, directed that

a judgment be entered in favor of the plaintiff as demanded in the complaint:

Now, upon motion of Messrs. Kellogg & Rose, attorneys for the plaintiff, it is

Adjudged that the plaintiff, Kerbaugh-Empire Company, have judgment against the defendant, Frank K. Bowers, as collector of internal revenue, second New York district, the defendant, for the sum of five thousand one hundred and ninety-eight and 77/100 ($5,198.77) dollars, with interest thereon at six (6%) per cent from the 13th day of June, 1922, amounting to five hundred and ninety-eight and 18/100 ($598.18) dollars, aggregating the sum of five thousand seven hundred and ninety-six and 95/100 ($5,796.95) dollars, together with costs taxed at the sum of twenty-seven and 45/100 dollars ($27.45), making a total of fifty-eight hundred and
74 twenty-four and 40/100 dollars ($5,824.40), and that the plaintiff, Kerbaugh-Empire Company, have execution therefor.

Judgment signed this 20th day of May, 1924.

ALEX GILCHRIST, JR.,
Clerk.

[File indorsement omitted.]

75 In United States District Court

Certificate of probable cause

Filed May 20, 1924

[Title omitted.]

This action having been commenced by the service of a summons and complaint on the 7th day of September, 1922, and an amended complaint having been served on the 2d day of July, 1923, and the defendant, Frank H. Bowers, as collector of internal revenue, Second New York District, having appeared herein on the 22d day of September, 1922, by William Hayward, United States Attorney for the Southern District of New York, attorney for said defendant, and the said William Hayward having on the 5th day of July, 1923, served a notice of motion to dismiss the said amended complaint, and the said motion having come on to be heard before me on the 8th day of February, 1924, and a decision having been made on said motion on the 18th day of April, 1924, wherein and whereby the said motion of the defendant for judgment on the pleadings was denied with a direction that a decree be entered in favor of the plaintiff, according and pursuant to such order, judgment
76 having been entered herein in favor of the plaintiff and against the defendant in the sum of fifty-eight hundred and twenty-four dollars and 40/100 cents ($5,824.40).

Now, therefore, pursuant to section 989 of the Revised Statutes of the United States, I hereby certify that there was probable cause for the acts done by the defendant, Frank K. Bowers, as collector of internal revenue, Second New York District, in collecting the tax

which is the subject of this action, and by reason of which judgment has been rendered against him.

HENRY W. GODDARD,
U.S.D.J.

Consented to:

WM. HAYWARD,
U.S. Attorney, atty. for deft., May 2, 1924.

[File indorsement omitted.]

77 In United States District Court

Assignment of errors

Filed Aug. 16, 1924

Now comes the above-named defendant by his attorney, William Hayward, United States attorney for the Southern District of New York, and files the following assignment of errors, and says that the judgment entered in this cause on May 20, 1924, is erroneous and unjust, for the following reasons:

I. The court erred in holding and deciding that the sum of $684,456.18, representing the difference between the dollar equivalent of the 3,216,445 reichsmarks borrowed by plaintiff from the Deutsche Bank at the rate of exchange current at the time said advances were made to it by the Deutsche Bank (approximately $770,000), and the dollar equivalent of the said 3,216,445 reichsmarks at the rate of exchange of 2½¢ per reichsmark, to wit, $80,411.12, at which rate and for which said sum plaintiff settled and liquidated its indebtedness to the Deutsche Bank in 1921, by agreement with the Alien Property Custodian, under the provisions of the trading with the enemy act, did not constitute taxable income to the plaintiff for the calendar year 1921 within the purview of the 16th amendment to the Constitution of the United States.

78 II. The court erred in holding and deciding that the aforesaid sum of $684,456.18, representing the difference between the dollar equivalent of the 3,216,445 reichsmarks borrowed by plaintiff from the Deutsche Bank at the rate of exchange current at the time said advances were made to it by the Deutsche Bank (approximately $770,000) and the dollar equivalent of the said 3,216,445 reichsmarks at the rate of exchange of 2½¢ per reichsmark, to wit, $80,411.12, at which rate and for which said sum plaintiff settled and liquidated its indebtedness to the Deutsche Bank in 1921 by agreement with the Alien Property Custodian, pursuant to the provisions of the trading with the enemy act, did not constitute taxable income to plaintiff for the calendar year 1921 under the provisions of the revenue act of 1921.

III. The court erred in denying defendant's motion for judgment in his favor on the pleadings.

IV. The court erred in directing the entry of judgment in favor of the plaintiff and against the defendant for the sum of $5,824.40, with interest.

Wherefore defendant prays that the judgment of the District Court of the United States for the Southern District of New York be reversed and that the said District Court be directed to enter judgment dismissing the complaint herein upon the merits.

WILLIAM HAYWARD,
United States Attorney for the Southern District of New York.

79 In United States District Court

[Title omitted.]

Petition for writ of error

Filed Aug. 16, 1924

To the honorable judges of the United States Court for the Southern District of New York:

Now comes Frank K. Bowers, the defendant herein, by his attorney, William Hayward, United States attorney for the Southern District of New York, and feeling himself aggrieved by the judgment entered herein on May 20, 1924, in favor of the plaintiff and against this defendant, by which said judgment it was adjudged that the plaintiff have and recover from the defendant the sum of $5,824.40, and that plaintiff have execution therefor against this defendant, in which judgment and the proceedings had in this cause prior to the entry thereof certain errors were committed to the prejudice of this defendant, all of which more fully appears in the assignment of errors filed herewith:

80 Wherefore, defendant prays that a writ of error may issue in his behalf out of the Supreme Court of the United States for the Southern District of New York for the correction of the errors so complained of, and that a transcript of the record, proceedings, and papers in this case, duly authenticated, may be sent to the Supreme Court of the United States.

Dated New York, August 16, 1924.

WILLIAM HAYWARD,
United States Attorney for the Southern District of New York,
Attorney for Defendant.

Office & P. O. address: U. S. Courts & P. O. Bldg., Borough of Manhattan, city of New York.

81 [Citation in usual form, showing service on Kellogg and Rose, filed Aug. 19, 1924, omitted in printing.]

(Indorsed on cover:) File No. 30617. D. C. U. S., S. New York. Term No. 173. Frank K. Bowers, collector of internal revenue for the second district of New York, plaintiff in error, vs. Kerbaugh-Empire Company. Filed September 15th, 1924. File No. 30617.

O

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In the Supreme Court of the United States

OCTOBER TERM, 1925

No. 173

FRANK K. BOWERS, COLLECTOR OF INTERNAL REVENUE for the Second District of New York, plaintiff in error

v.

KERBAUGH-EMPIRE COMPANY

IN ERROR TO THE DISTRICT COURT OF THE UNITED STATES FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIEF ON BEHALF OF PLAINTIFF IN ERROR

OPINION OF THE COURT BELOW

The opinion of the United States District Court for the Southern District of New York (R. 49) is reported in 300 Fed. 938.

GROUNDS OF JURISDICTION

The question in this case is whether or not the profit or gain made by a corporation as the result of borrowing foreign money and later settling its debt at a rate of exchange lower than that at which the loan was made is taxable income.

The amended bill of complaint alleged that it was not income within the meaning of the Sixteenth

Amendment to the Constitution. (R. 10–11.) The District Court, upon a motion to dismiss, expressly held it was not income within the meaning of the Sixteenth Amendment. (R. 57.) From that judgment, entered on May 20, 1924 (R. 57), the case was brought directly to this Court on writ of error issued August 16, 1924 (R. 1), under Section 238 of the Judicial Code as that code stood prior to the amendment of February 13, 1925.

STATEMENT

The Kerbaugh-Empire Company is a corporation organized under the laws of New York. In 1911 it was the owner of all the stock of certain subsidiary corporations, including H. S. Kerbaugh, Incorporated, a Pennsylvania corporation. This subsidiary was engaged in extensive construction work. On or about June 8, 1911, the Kerbaugh-Empire Company entered into negotiations with the Deutsche Bank, of Berlin, Germany, through the bank's New York agent, one Edward D. Adams, for the loan of money with which to finance the operations of H. S. Kerbaugh, Incorporated. (R. 3.) The bank agreed to loan the money, but only on condition that the notes given in exchange therefor by Kerbaugh-Empire Company be made payable as to both principal and interest in German marks or their equivalent in United States gold coin at prime bankers' rate in New York for cable transfer to Berlin, Germany. The loans were made in accordance with the following

procedure: The Kerbaugh-Empire Company would advise Mr. Adams, the New York representative of the bank, the amount of money it needed in terms of dollars. Mr. Adams would cable the bank in Berlin for the amount of marks equivalent to the company's need in dollars. The bank would then, by cable transfer, credit Mr. Adams in some bank in New York with the number of marks equivalent to the number of dollars needed by the company. Mr. Adams, upon receipt of this credit, would draw his check on the bank, payable in dollars, to Kerbaugh-Empire Company. In exchange for each check the company would turn over to Mr. Adams its promissory note payable in marks. (R. 4.)

Between June 8, 1911, and July 1, 1913, in the above manner the bank loaned Kerbaugh-Empire Company 8,341,337.50 marks, the equivalent of $1,983,000 (R. 5), at the prevailing rate of exchange of about 24 cents per mark (R. 45). This sum was advanced by Kerbaugh-Empire Company to its subsidiary H. S. Kerbaugh, Incorporated, and was lost by the latter in its construction work. This loss was allowed as deductions in the income tax returns of H. S. Kerbaugh, Incorporated, for the years 1913, 1914, 1916, 1917, and 1918. (R. 6.)

By September 1, 1913, Kerbaugh-Empire Company had made such payments on account that the amount of the loan had been reduced to 6,740,800 marks. On that date all the company's old notes were surrendered and a new note given by it to

the bank for the unpaid balance. (R. 5.) Upon the due date of this note it also was surrendered and Kerbaugh-Empire Company delivered to the Deutsche Bank another note, dated March 2, 1914, payable April 1, 1915, for said unpaid balance of 6,740,800 marks. (R. 6.) Thereafter such payments were made on this note that by March 31, 1915, the principal amount thereof had been reduced to 3,216,445 marks (R. 6), the equivalent of $764,867.30. On April 6, 1915, by a written agreement this note was made payable on demand after ten days' notice. (R. 18.)

After the United States entered the World War the Alien Property Custodian, on October 2, 1919, called upon Kerbaugh-Empire Company to pay over to him the balance due on the note, the Deutsche Bank being an alien enemy. (R. 22.) On August 31, 1921, after considerable dispute, Kerbaugh-Empire Company by reason of a fall in the value of the mark negotiated a full settlement of both principal and interest by the payment to the Alien Property Custodian of $113,688.23. (R. 23–25.) Of this sum, $80,411.12 represented principal and $33,277.11 interest. (R. 46.) The result was that Kerbaugh-Empire Company satisfied the principal of its note for 3,216,445 marks, for which it had received $764,867.30 (computation at about 24 cents per mark), by the payment of $80,411.12 (computation at about 2½ cents per mark). The difference between these two sums, amounting to $684,456.18, the Commissioner of In-

ternal Revenue treated as income for the year 1921 and assessed thereon a tax of $10,320.14. Without this item Kerbaugh-Empire Company's income tax return shows no taxable income, but a deficit. (R. 30.) Payment under protest was made of $5,198.77, being two quarterly instalments of the tax with interest, and this action brought for recovery. (R. 10, 11.) Upon a motion to dismiss, judgment was given by the District Court in favor of defendant in error (R. 57) on the ground that the gain of $684,456.18 to Kerbaugh-Empire Company was not income within the meaning of the Sixteenth Amendment to the Constitution and the Revenue Act of 1921 (42 Stat. 227, ch. 136).

STATUTES INVOLVED

The pertinent provisions of the Revenue Act of 1921 are as follows:

> SEC. 230. That, in lieu of the tax imposed by section 230 of the Revenue Act of 1918, there shall be levied, collected, and paid for each taxable year upon the net income of every corporation a tax at the following rates:
>
> (a) For the calendar year 1921, 10 per centum of the amount of the net income in excess of the credits provided in section 236 * * *.
>
> SEC. 232. That in the case of a corporation subject to the tax imposed by section 230 the term "net income" means the gross income as defined in section 233 less the deductions allowed by section 234 * * *.

SEC. 233. (a) That in the case of a corporation subject to the tax imposed by section 230 the term "gross income" means the gross income as defined in sections 213 and 217 * * *.

SEC. 213. That for the purposes of this title (except as otherwise provided in section 233) the term "gross income"—

(a) Includes gains, profits, and income derived from * * * businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from * * * the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. The amount of all such items (* * *) shall be included in the gross income for the taxable year in which received by the taxpayer * * *.

SPECIFICATION OF ERRORS TO BE URGED

(1) The court erred in holding that the cash gain of $684,456.18 realized by defendant in error as the result of borrowing foreign money in 1911, 1912, and 1913, and settling its debt in 1921 at a rate of exchange lower than that at which the loan was made is not income for the year 1921 under the Sixteenth Amendment to the Constitution and the Revenue Act of 1921, *supra.*

(2) The court erred in holding that the instant case should be governed by *United States* v. *Oregon-Washington R. and Nav. Co.,* 251 Fed. 211.

ARGUMENT

Summary

I. The cash gain realized by defendant in error as the result of borrowing foreign money and discharging its debt at a rate of exchange lower than that at which the loan was made is taxable income to it for the year 1921.

II. The case of United States v. Oregon-Washington R. and Nav. Co., 251 Fed. 211, is not in point.

I

The cash gain realized by defendant in error as the result of borrowing foreign money and discharging its debt at a rate of exchange lower than that at which the loan was made is taxable income to it for the year 1921

The facts on their face show that as a result of the transaction involved in this case defendant in error realized a cash gain of $684,456.18. No amount of argument however ingenious can disguise the fact that its assets were increased to that extent. Looked at from any possible angle, the fact remains that defendant in error received $764,867.30, for which it gave in return only $80,411.12—a clear gain of $684,456.18. The transaction was concluded in 1921 by the payment of the lesser amount. That act determines the fact and time of the realization of the gain.

It is equally clear that this gain is income. The language of the Sixteenth Amendment is, income "from whatever source derived." In the revenue laws enacted under the authority of the Amend-

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ment, Congress intended to tax incomes to the fullest extent permitted thereby. *Eisner* v. *Macomber*, 252 U. S. 189, 203. The Revenue Act of 1921, *supra*, levies an income tax upon gains, profits, and income from businesses, commerce, sales or dealings in real or personal property growing out of the ownership or use of or interest in such property and from the transaction of any business carried on for gain or profit and " gains or profits and income derived from any source whatever."

If in the face of these express provisions, which are as broad and comprehensive as language will permit, there can be any doubt that the gain in question is income—and we submit there cannot be—it is conclusively removed by the decisions of this Court.

Under the Corporation Tax Act of 1909 and the various income tax laws, this Court has had frequent occasion to say what constitutes income within the meaning of the Sixteenth Amendment. In *Stratton's Independence* v. *Howbert*, 231 U. S. 399, income was first defined as "the *gain* derived from capital, from labor, or from both combined " (p. 415). In subsequent decisions other synonyms are used in explanation or elaboration of the meaning of the word " income." Thus in *Doyle* v. *Mitchell Brothers Co.*, 247 U. S. 179, it was referred to as the " *gain* or increase arising from corporate activities " (p. 185), and also as " the result of the operation and management of the business or

property of the corporation" (p. 187). In *Hays v. Gauley Mt. Coal Company*, 247 U. S. 189, 193, it is referred to as the "increase arising from *corporate activities.*" Thereafter, in *Eisner* v. *Macomber*, 252 U. S. 189, 207, this Court reaffirmed the definition given in these three cases, but elaborated it further to read:

> * * * "Income may be defined as the gain derived from capital, from labor, or from both combined," provided it be understood to include profit gained through a sale or conversion of capital assets * * *
>
> The Government, although basing its argument upon the definition as quoted, placed chief emphasis upon the word "gain," which was extended to include a variety of meanings; while the significance of the next three words was either overlooked or misconceived. "*Derived—from—capital*";—"the *gain—derived—from—capital,*" etc. Here we have the essential matter: *not* a gain *accruing to* capital, not a *growth* or *increment* of value *in* the investment; but a gain, a profit, something of exchangeable value *proceeding from* the property, *severed from* the capital however invested or employed, and *coming in*, being "*derived,*" that is, *received* or *drawn by* the recipient (the taxpayer) for his *separate* use, benefit and disposal;—*that* is income derived from property. Nothing else answers the description. (Italics judicial.)

This definition was again somewhat elaborated in subsequent cases, but it should be construed with

reference to the facts then under consideration. As the Court said in the *Eisner case,* speaking of the above definition (p. 207):

> Brief as it is, it indicates the characteristic and distinguishing attribute of income essential for a *correct solution of the present controversy.* (Italics ours.)

In holding that the gain in question was not income under the *Eisner case,* the court below evidently confused the *application of the definition* of income in that case with the *definition itself.* In that case the Court had under consideration only the question whether or not profits or increase of assets to the corporation was income to a stockholder of that corporation. There is nothing whatever in the *Eisner case* to justify holding, as the court below did, that a gain such as that derived by the corporation here involved through the use of capital (borrowed)—that is, by reason of its ability in financing its corporate activities to take advantage of the opportune conditions in the foreign money market —is not income to the corporation. On the contrary, in that case, in speaking of the increase in the assets of the corporation there involved, likewise derived from corporate activities, as in the present case, the Court specifically says (p. 214):

> Did we regard corporation and stockholders as altogether identical, there would be no income except as the corporation acquired it; and while *this would be taxable against the*

> *corporation as income* under appropriate provisions of law, the individual stockholders could not be separately and additionally taxed * * *. (Italics ours.)

In the instant case there is no question of an undivided increase in the assets of a corporation being income *to a stockholder*. There is simply the question whether or not such a gain is income *to the corporation*. As it was income to the corporation in the *Eisner case*, so it must be income to the corporation in this case.

When this Court said in the *Eisner case* that income was "gain derived from capital, from labor, or from both combined," or, as it said in the *Doyle case*, a "gain arising from corporate activities," it never intended to exclude the result of good fortune and the skill and address with which corporate officers in borrowing money take advantage of the fluctuations and contingencies affecting the general financial conditions of the country. If the sum of $684,456.18 obtained by a corporation by the expenditure of $80,411.12 is not income, what is it? When $764,867.30 was received by the corporation in 1911, 1912 and 1913 from the bank it must have been entered upon the corporate books where it would show as an increase in the assets of the corporation in that amount offset by a corresponding increase in liabilities; but when in 1921, $80,411.12 was returned to the bank the books would show a decrease in assets in that amount with a decrease in liabilities of $764,867.30. The difference of

$684,456.18, we submit, would properly at that time be carried to the profit and loss account as a profit. This would not be a mere bookkeeping transaction—a mere marking up of the increment of value of fixed assets. We concede that until the actual payment of $80,411.12 the possibility of discharging the debt in that amount would be merely an accretion to capital, *but when in 1921 that sum was actually paid and the transaction finally closed, we submit that by that act the gain was definitely realized as income.* If not then realized by the corporation as income, how and when could it ever be realized?

In suggesting that the gain in question was not realized income, but a mere increment of value, the court below was influenced by the fact, strongly stressed by defendant in error's brief below, that the money received by it from the bank had been lost by H. S. Kerbaugh, Incorporated, a subsidiary, to which it had been advanced. This is not a factor in the case at all. In the first place, so far as the record shows defendant in error itself has never claimed any loss in connection with the transaction under consideration either in the year here involved (1921) or in any other year. While the record does show the loan of the money by defendant in error, Kerbaugh-Empire Company, to its subsidiary, H. S. Kerbaugh, Incorporated, and its subsequent loss by the latter, it does not show that the money has not been or will not be repaid by H. S. Kerbaugh, Incorporated, to defendant in error.

However, the question of the subsidiary's losses, for which, it should be noted, they were allowed deductions in the appropriate years, has nothing whatever to do with the gain realized by defendant in error from its transaction with the bank. The subsidiary is not the taxpayer before the Court. It is a total stranger to the controversy. As this Court said in *Carbon Steel Co.* v. *Lewellyn,* 251 U. S. 501, 506, with reference to a similar situation:

> * * * it is a sufficient answer to say that the tax here in issue is the tax on the profits of the petitioner, not on the profits of the subcontractors. The question whether such subcontractors were correctly assessed concerns them and not the petitioner who is resisting a tax on the profits actually made by it and none other.

Finally, and this, it seems to us, is conclusive on the point, taxable net income is determined when a balance is struck at the end of the year. The tax when thus ascertained is assessable against the whole of the taxpayer's estate. There is neither an actual nor a constructive carving of the tax out of any fund identified as income. Nor can collection of the tax, once it is determined, be defeated by investment, theft or destruction. It is enough that it was realized as income during the year. This was specifically recognized by this Court in the *Eisner case,* where it was said (252 U. S. 189, 209–210):

> The profits of a corporation, as they appear upon the balance sheet at the end of the year, need not be in the form of money on

> hand in excess of what is required to meet current liabilities and finance current operations of the company. Often, especially in a growing business, only a part, sometimes a small part, of the year's profits is in property capable of division; the remainder having been absorbed in the acquisition of increased plant, equipment, stock in trade, or accounts receivable, or *in decrease of outstanding liabilities.* (Italics ours.)

That is exactly the situation here.

There are several ways of more closely viewing the transaction involved in this case. All of them, however, lead to the same inevitable conclusion that the resultant gain is income. One way—and a most logical one—is to treat it as a transaction in foreign exchange. Viewed in that light, we find that defendant in error received from the marks borrowed from the Deutsche Bank $764,867.30 under an agreement whereby in consideration thereof it agreed to deliver at a later date to the bank 3,216,445 marks or their equivalent in dollars, at the rate of exchange on that later date. In consummation of this agreement it delivered to a lawful representative of the bank on that date $80,411.12, the then equivalent of said 3,216,445 marks. In substance and effect this is plainly a " short " sale of marks. No one will contend that no income is received by the purchase of a certain number of marks at 24 cents per mark to be delivered at a future time and the fulfilment of that agreement by delivery of the same number of marks at 2½ cents per mark, or, as

happened in this case and which is in effect the same thing, by the discharge of the liability under the agreement by the payment in dollars of the value of the marks on the delivery date.

There can be no doubt that if the converse of this case had occurred and there had been an increase instead of a decrease in the value of the mark, defendant in error would have been entitled to deduct as a loss or business expenditure the additional sum required to be paid in discharge of the indebtedness. This rule should, of course, work both ways, and where, as in the instant case, the indebtedness has been discharged by the payment of a lesser amount, the resultant gain must necessarily be considered income.

The fact that defendant in error was not a dealer in foreign exchange, or that the transaction was not entered into by it with any idea of gain, is immaterial. This Court has definitely decided that increase in capital assets resulting from isolated or casual transactions outside a taxpayer's ordinary business operations is constitutionally taxable. *Merchants L. and T. Co.* v. *Smietanka,* 255 U. S. 509; *Eldorado Coal Co.* v. *Mager,* 255 U. S. 522; *Goodrich* v. *Edwards,* 255 U. S. 527; *Walsh* v. *Brewster,* 255 U. S. 536. Nor does it make any difference that defendant in error never actually came into possession of the marks themselves. Taxation is preeminently a practical matter, having to do with the substance rather than the

form of transactions. It is enough that the transaction here involved necessarily entailed a deal in foreign exchange in the interest and on behalf of defendant in error and that defendant in error directly realized a cash gain therefrom. Under all the circumstances, although the transaction may have varied in form, it is indistinguishable in principle from an ordinary transaction in foreign exchange, which is unquestionably taxable.

Another and equally logical way of viewing the transaction is to liken it to the purchase and retirement by a corporation of its own bonds at a price less than the issuing price. That such sales and retirements of corporate bonds result in income must be taken as settled. Article 545 of Regulations 62, relating to income tax under the Revenue Act of 1921 construing the statutory definition of income in its application to corporations, provides:

> (1) (a) If bonds are issued by a corporation at their face value, the corporation realizes no gain or loss. (b) If thereafter the corporation purchases and retires any of such bonds at a price in excess of the issuing price or face value, the excess of the purchase price over the issuing price or face value is a deductible expense for the taxable year. * * * (c) *If, however, the corporation purchases and retires any of such bonds at a price less than the issuing price or face value, the excess of the issuing price or face*

> *value over the purchase price is gain or income for the taxable year.* (Italics ours.)

This article is identical in words with Article 544 of Regulations 45 under the Revenue Act of 1918 and is again repeated in Article 545 of Regulations 65 under the 1924 Act.

It is unnecessary to burden this brief with a citation of authorities in support of the fundamental principles that a regulation of a Department of the Government has the force and effect of law if it be not in conflict with express statutory provisions (*United States* v. *Cerecedo Hermanos y Compania,* 209 U. S. 337), and that the reenactment by Congress, without change, of a statute which had previously received long-continued executive construction is an adoption by Congress of such construction (*National Lead Co.* v. *United States,* 252 U. S. 140, 146).

In *Baldwin Locomotive Works* v. *McCoach,* 221 Fed. 59, referring to the sale by a corporation of its bonds for 95 cents on the dollar, the court said (p. 60).

> The reality of the transaction was that the corporation pledged its credit and its property for $10,000,000, and *sold its promises to pay* for $9,500,000. (Italics ours.)

So in the instant case, the reality of the transaction is that defendant in error sold its promise to pay a certain number of marks for $764,867.30 and later bought this promise back for $80,411.12. The fact that this promise was in the

shape of a promissory note instead of a corporate bond did not affect the essential character of the transaction. Nor does the fact that the note itself was never actually returned to defendant in error make any material difference. So far as the practical result is concerned the receipt which the defendant in error received from the Alien Property Custodian is as effective as though the note itself had been returned and cancelled. In the present case, if the corporation had borrowed $764,867.30 through the sale of bonds which it later retired for $80,411.12, no one would doubt for a moment that under the Treasury regulations above referred to the difference between these sums would have been taxable as a part of its income. What was actually done was that the corporation borrowed $764,-867.30 through the sale of its note and retired that obligation for $80.411.12. Is there any conceivable difference in principle between the case supposed and that now under consideration? The analogy is perfect.

No matter how the transaction is viewed, the payment of $80,411.12 for $764,867.30 results in income at the time the lesser sum is paid. If we say that it is a capital transaction, then clearly it is a "gain through a sale or conversion of capital assets." If we say it is a gain through corporative activities it is equally clear that it is income. In either event the time when the income is realized is when the transaction involved is closed or the corporate activities ended—in this case, in 1921. Had

the corporation in 1913 bought for $80,411.12 marks which it sold for $764,867.30, clearly it would have made a gain of $684,456.18. The mere fact that this was not done, but that the transaction covered a long period of time and was not closed until eight years later by the payment of the lesser amount, does not affect the essentials. Except for the fact that the steps in the transaction occurred in reverse order, there is no real distinction so far as income is concerned between this and the purchase of property in 1913 for $80,411.12 and its sale in 1921 for $764,867.30. In either case there is a gain or profit actually realized. The mere fact that the transaction also results in the satisfaction of an obligation can not change its nature and effect. We are concerned with substance and not form.

With respect to the time of the realization of the gain, the transaction is again analogous to a "short" sale. In such transactions, which are common in commercial practice, a man borrows stock and obligates himself to return like stock at a later date. He sells the borrowed stock. He later fulfills his obligation to return the like stock by purchasing it at less than the price for which he sold. The difference between the price sold and the cost to return is clear gain and taxable income at the time the transaction is closed. The gain results then because he has been able to fulfill his obligation for less than it would have cost him on the date he borrowed the stock. That such a

gain is taxable income is well settled. The question of " short " sales at a profit or loss thereon as determined by and related to the income-tax laws was before the New York Supreme Court in the case of *People ex rel. Keim* v. *Wendell,* 193 N. Y. S. 143. Although the court in that case was considering a loss which it held to be deductible instead of a gain, and although the law there under consideration was a State statute, the principle is the same, and what was there held would likewise apply to the Federal law. It is expressly held in the *Wendell case, supra,* that the time of the realization of the gain or loss resulting from " short " sales is when the transaction is finally closed. This is also recognized by textbook writers. The general rule is stated in Holmes Federal Taxes, Sixth Edition (p. 569), as follows:

> * * * where a taxpayer has " borrowed " stock in order to make a " short " sale the gain or loss arising from the transaction can not be accrued upon the books of the taxpayer at the close of his taxable year by treating as an offsetting obligation the market value of the stock sold " short " as of that date; *the gain or loss is determined when the amount of stock sold " short " is repurchased for return to the lender and the transaction closed.* (Italics ours.)

A case directly in point and controlling upon this feature is *Great Northern Ry. Co.* v. *Lynch,* 292 Fed. 903. In that case, arising under the Corporation Tax Act of 1909, the amount of certain unpaid

obligations of a corporation when written off the books because outlawed by the statute of limitations was held to be income under the Corporation Tax Act *in the year in which written off.* This case was not called to the attention of the court below, nor apparently was it considered by it. The word "income" as used in the Corporation Tax Act has, of course, the same meaning as in the Revenue Act of 1921 here under consideration. *Merchants L. and T. Co.* v. *Smietanka,* 255 U. S. 509; *Southern Pacific Co.* v. *Lowe,* 247 U. S. 330. If income results in the *Great Northern case,* it also results in the instant case. If it was realized in the *Great Northern case* in 1910 and 1911, when the indebtedness was written off the books by reason of the statute of limitations, it is realized in the instant case in 1921, when the transaction is finally closed by the discharge of the indebtedness through the payment of the lesser amount.

It is to be borne in mind that in arguing this case the Government is not wedded to any particular theory as to the nature of the transaction from a legal standpoint. Whatever may be its nature, the result is the same. We have shown merely by way of illustration that whether this transaction be viewed as a "short" sale of marks or a "short" sale of credit, or simply a cancellation of indebtedness (the *Great Northern case, supra*), the inevitable result is income. We rest our case, however, on broader grounds. We believe that the one best and sufficient reason why it is income is that there

is no gainsaying that defendant in error in 1921 realized a gain of $684,456.18 by the expenditure of $80,411.12, and that the common understanding of the word "income" as frequently defined by this Court is sufficiently broad to include this gain derived in the manner and from the source disclosed by the facts of this case. It would certainly surprise the man in the street, for whom the tax laws are intended, to be told that if he realized a gain under the circumstances of this case he would not be in receipt of income. If this gain is not income "derived from whatever source" within the meaning of the Revenue Act of 1921, then, as stated by Mr. Justice Holmes in *Irwin* v. *Gavit*, 268 U. S. 161, that Act has "missed so much of the general purpose that it expresses at the start."

II

The case of United States v. Oregon-Washington R. and Nav. Co., 251 Fed. 211, is not in point

The Government might well rest here were it not for the fact that the lower court finally based its decision on the case of *United States* v. *Oregon-Washington R. and Nav. Co.*, 251 Fed. 211. It is insisted that that case conclusively determines that a cancellation of an indebtedness is not income. The contention is not sound. An examination of the facts and the decision in that case shows so clearly that it is not in point that its discussion need not long detain us.

In the *Oregon-Washington case* it appears that the Oregon Short Line Company owned all the

stock of the Oregon-Washington Railway and Navigation Company. The Short Line Company had also advanced a considerable sum of money to the Oregon-Washington Railway and Navigation Company. In a rearrangement of these book items the Short Line Company released its debt against the Oregon-Washington Railway and Navigation Company to the amount of $6,000,000 (in round numbers). This release the Government sought to treat as part of the income of the Oregon-Washington Railway and Navigation Company for that year. The fact that the Short Line Company owned all the stock of the Oregon-Washington Railway and Navigation Company and also the debt, made the release of the debt exactly the same as a *contribution to the capital* of the Oregon-Washington Railway and Navigation Company. This is the sole ground upon which the court rested its decision that the transaction did not result in income. It said (p. 213):

> * * * the word [income] * * * should not include such wealth as is honestly appropriated to what would customarily be regarded as the capital of the corporation taxed.
>
> Now, it seems to us hardly arguable that the cancellation of the debt in question was not in the category of capital. The corporation had just commenced its business; *the cancellation of the debt was a means of contribution to its capital account, quite as though the money had been*

> *contributed by the stockholder only to enhance the value of his stock.* (Italics ours.)

The conditions as to ownership of the two corporations were the same as in *Southern Pacific Co.* v. *Lowe,* 247 U. S. 330, in which this Court said (pp. 337–338):

> * * * the Central Pacific and the Southern Pacific were in substance identical because of the complete ownership and control which the latter possessed over the former, as stockholder and in other capacities. While the two companies were separate legal entities, yet in fact, and for all practical purposes they were merged, the former being but a part of the latter, acting merely as its agent and subject in all things to its proper direction and control. And, besides, the funds represented by the dividends were in the actual possession and control of the Southern Pacific as well before as after the declaration of the dividends. The fact that the books were kept in accordance with the provisions of the lease, so that these funds appeared upon the accounts as an indebtedness of the lessee to the lessor, cannot be controlling, in view of the practical identity between lessor and lessee. Aside from the interests of creditors and the public—and there is nothing to suggest that the interests of either were concerned in the disposition of the surplus of the Central Pacific—the Southern Pacific was entitled to dispose of the matter as it saw fit.

So in the *Oregon-Washington case,* there was no change whatever in the actual assets of the two companies by the transaction there involved, but only a change of the book entries, and neither the Short Line Company nor the Oregon-Washington Railway and Navigation Company had any increase or decrease in its assets after the transaction from what it had before.

In the instant case, however, there has been an increase in the assets of defendant in error as the result of the transaction in question.

Upon final analysis, as we have just seen, it is quite plain that in the *Oregon-Washington case* all that was decided, or upon the facts all that could have been decided, was that when a cancellation of indebtedness amounts in substance to a contribution of capital it is not income—only that and nothing more.

As we have also seen, the facts and ultimate result of the transaction here under consideration are entirely different from those in the *Oregon-Washington case.* No amount of ingenuity can succeed in torturing the facts of this transaction into a case of *contribution of capital* so as to bring it within the rule of that case.

We confidently submit, therefore, that the *Oregon-Washington case* clearly is not in point. Nor even is it authority for the general proposition that the cancellation of indebtedness does not result in income. The only case in point on that question it has been possible to find is *Great North-*

ern Ry. Co. v. *Lynch,* 292 Fed. 903. In that case, as we have shown in our previous argument, it was held that the amount of certain unpaid obligations of a corporation when written off the corporate books because outlawed by the statute of limitations was income to that corporation in the year in which written off. There we have a transaction similar so far as the essentials are concerned to the present case. If it was income in that case, by analogy it is also income in the present case.

CONCLUSION

It should be remembered that the Government is not here claiming that every cancellation of indebtedness necessarily results in income. Whether or not it results in income depends upon the circumstances for its effect. It might result in a capital transaction, such as the distribution of a bankrupt's assets to its creditors, or a contribution of capital, as in the *Oregon-Washington R. and Nav. Company case, supra,* or, under certain circumstances, a pure gift. Our contention is simply this: Where a going and apparently solvent corporation in the course of financing its corporate activities makes a cash gain of $684,456.18 by borrowing foreign money and later settling its debt at a rate of exchange lower than that at which the loan was made, it is the recipient of income in the year of the repayment to the extent of the difference in dollars between the amount received and the amount repaid, under *Great Northern Ry. Co.* v. *Lynch,* 292

Fed. 903; *Eisner* v. *Macomber*, 252 U. S. 189, and other cases decided by this Court.

For these reasons it is respectfully submitted that the judgment of the District Court should be reversed.

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DECEMBER, 1925.

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WM. R. STANS

IN THE

Supreme Court of the United States,

OCTOBER TERM, 1925—No. 173.

FRANK K. BOWERS, Collector of Internal Revenue for the Second District of New York,
Plaintiff-in-Error,

—against—

KERBAUGH-EMPIRE COMPANY,
Defendant-in-Error.

IN ERROR TO THE DISTRICT COURT OF THE UNITED STATES FOR THE SOUTHERN DISTRICT OF NEW YORK.

BRIEF ON BEHALF OF DEFENDANT-IN-ERROR.

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IN THE

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FRANK K. BOWERS, Collector of Internal Revenue for the Second District of New York,

Plaintiff-in-Error,

—against—

KERBAUGH-EMPIRE COMPANY,

Defendant-in-Error.

In Error to the District Court of the United States, for the Southern District of New York.

BRIEF ON BEHALF OF DEFENDANT-IN-ERROR.

Statement.

The Kerbaugh-Empire Company, a New York corporation (hereinafter referred to as the taxpayer), owning all of the stock of a subsidiary corporation, H. S. Kerbaugh, Incorporated, was in 1911 in need of funds for financing its subsidiary in the performance of large construction contracts. For that purpose it applied to the Deutsche Bank for loans. The bank agreed to loan funds for the purposes as stated by cabling to its New York representative an amount of marks equivalent to the taxpayer's needs in dollars, such loans to be evidenced by the notes of the taxpayer payable in marks

or their equivalent in United States Gold Coin (R., pp. 3-4).

In accordance with that arrangement, between June 8th, 1911, and July 1st, 1913, the bank transmitted to its representative, for the taxpayer, 8,341,337.5 marks, the equivalent value of which at the time of such loans and as received by the taxpayer was the sum of $1,983,000. The loans so had by the taxpayer were in turn, in accordance with the arrangement, loaned to its subsidiary, H. S. Kerbaugh, Incorporated, and were totally lost by it in the performance of its construction contracts. H. S. Kerbaugh, Incorporated (separate returns being required by the income tax laws prior to 1918), reported those losses in its income tax returns for the years 1913, 1914, 1916, 1917 and 1918. The amount of such losses was in excess of the income in those years. The excess of losses over income in those years exceeded the amount of the item on which the taxpayer has been taxed (R., p. 6).

On March 2nd, 1914, payments having been made by the taxpayer which reduced the amount of such loans to 6,740,800 marks, the taxpayer made and delivered its promissory note dated March 2nd, 1914, payable April 1st, 1915, for that amount of marks (R., p. 6).

Later, in 1914 and in 1915, by payments made by the taxpayer in marks on account, the balance, unpaid on said note was reduced to 3,216,445 marks (R., p. 6). By a later written agreement between the taxpayer and the bank, the unpaid balance was to be paid ten days after written demand. Report of the indebtedness was duly made to the Alien Property Custodian, demand was made by the Alien Property Custodian for its payment, and after said demand, tender of the amount of the note in marks

at the then rate of exchange was made. The rate of exchange at the time of the tender was 2.18c. per mark. Settlement of the obligation was made at a slightly higher rate, to wit, 2.5c. per mark, that is, the unpaid balance of principal in marks, 3,216,445 (of a value when borrowed 1911-1913 of $764,867.30), was settled by payment to the Alien Property Custodian of the sum of $80,411.12, or a difference in value of the marks of $684,456.18 (R., pp. 7-8, 22).

The Question Presented.

Did the taxpayer, because it borrowed marks in 1911, 1912 and 1913, to be loaned in turn to its subsidiary, the amount of which loans was totally lost in the operation of its subsidiary in years prior to 1918, realize any taxable income in 1921 when it repaid the exact amount of marks which it had borrowed, and which then remained unpaid, because due to decrease in the value of marks, it was able to liquidate that indebtedness for a smaller sum in dollars than those marks were worth in 1911, 1912 and 1913 when they were borrowed?

Summary of Argument.

I. The item of $684,456.18 included under protest in the taxpayer's return for the year 1921 *was not income* within the authority and intent of the Sixteenth Amendment to the United States Constitution.

II. If it be assumed, for the sake of argument, that the item of $684,456.18 was income, that sum *was not received in 1921* and was not income in that year.

Argument.

I.

The item of $684,456.18 included under protest in the taxpayer's return for the year 1921 *was not income* within the authority and intent of the Sixteenth Amendment to the United States Constitution.

The Sixteenth Amendment grants power to Congress "to lay and collect taxes on incomes, from whatever source derived * * *."

The question under this point is, therefore, whether the item on which the taxpayer was taxed is "income", "from whatever source derived" under the Amendment. Unless it is "income" then, of course, as a direct tax on personal property, without apportionment, its imposition on the taxpayer in this case would be beyond the powers of Congress under *Pollock* v. *Farmers' Loan & Trust Company*, 157 U. S. 429.

The word "income" was repeatedly defined by this Court in its decisions under the Corporation Tax Act, and, after adoption of the Sixteenth Amendment was defined in various cases arising under the Internal Revenue Acts passed subsequent to the Amendment. In *Eisner* v. *Macomber*, 252 U. S. 189, this Court adopted a definition of the word "income" based on, but somewhat elaborating, its previous definitions, and that definition has been reiterated and reaffirmed in all of its subsequent decisions. That definition, reaffirmed in the later cases of *Merchants Loan & Trust Company* v.

Smietanka, 255 U. S. 509; *United States* v. *Phellis*, 257 U. S. 156, and *Weiss* v. *Stearn*, 265 U. S. 242, is:

> "Income may be defined as the gain derived from capital, from labor, or from both combined, provided it be understood to include profit gained through a sale or conversion of capital assets" (p. 207).

As analyzed by the Court below, in its opinion, that definition includes five elements:

1. Gain derived from capital.
2. Gain derived from labor.
3. Gain derived from capital and labor combined.
4. Profit gained through sale of capital assets.
5. Profit gained through conversion of capital assets.

The Statement of Facts would clearly indicate that the item in question, the source of the tax assessed against the taxpayer, was not derived from the use of capital or from the use of labor or from a combined use of capital and labor. It was not a gain from sale of capital assets, because there was no sale. That leaves then for consideration only the element of profit through conversion of capital assets.

Income resultant from conversion of capital assets is exemplified in the cases of *United States* v. *Phellis*, *supra*; *Rockefeller* v. *United States*, 257 U. S. 176; *Cullinan* v. *Walker*, 262 U. S. 134.

In the case at bar, no capital asset was converted. All that the taxpayer did was to pay exactly what it had agreed to pay, no more and no less.

In explanation of its definition of income in *Eisner* v. *Macomber*, *supra*, this Court said that to constitute income as the result of a conversion of capital assets, there must be in the hands of the taxpayer

> "something of exchangeable value *proceeding from* the property, *severed from* the capital, however invested or employed, and *coming in*, being 'derived', that is *received* or *drawn by* the recipient (the taxpayer) for his *separate* use, benefit, and disposal; *that* is income derived from property. Nothing else answers the description" (p. 207).

In 1921, when the taxpayer liquidated its mark indebtedness, it not only did not "derive" or "receive" for its "separate use, benefit and disposal" anything from "the property", *i. e.*, the proceeds of the loan, but, as a matter of fact, "the property" itself, *i. e.*, the entire proceeds of the loan, had been completely lost years before in construction contracts. That being so, it is clear that when the taxpayer paid its mark indebtedness in the exact amount of marks that remained unpaid, all that the transaction could possibly embrace was a book entry and adjustment of its accounts to show that that payment had been made, and that the indebtedness was at an end. That payment of indebtedness in the exact form and exact amount in which the taxpayer had agreed to pay it (because it had agreed to pay marks or their equivalent in United States gold coin, and not dollars), *severed* nothing from the

capital, *because no capital remained from which anything could be severed.* It brought nothing *into* the hands of the taxpayer. There was nothing *received* or *drawn* by the taxpayer for its separate use and disposal for the reason that what happened was a *payment out* instead of a *receipt in.* By no stretching of words or straining of meaning can the act of the taxpayer in paying in 1921 exactly what for eight years it had been under an obligation to pay, create *income* within the meaning of "income" as defined in *Eisner* v. *Macomber*, *supra*, and as explained in the opinion of the Court.

Unless brought within that definition it is not income, for the Court said: "Nothing else answers the description".

In the *Eisner* case the term "income", it was said, must be defined as it is used in common speech. The word "income" certainly means something entirely different from the payment of a debt. When we consider that all that happened in 1921 was the payment of exactly what the taxpayer had agreed to pay, there could be no income from the capital involved in the transaction with the bank, because the very capital borrowed from the bank had been lost years before, and the only possible entry into the situation of the taxpayer's capital was when its other assets were depleted to pay the indebtedness. Lost as the amount borrowed had been, it certainly could not be used, sold or converted in 1921, to produce income subject to taxation. Instead of having an increment of "exchangeable value *proceeding from* the property, *severed from* the capital, however invested or employed, and *coming in*, '*being derived*', that is, *received* or *drawn by* the recipient (the taxpayer) for his *separate* use, benefit and disposal", there was only a capital de-

crease at that time, that decrease being the amount which the taxpayer was obligated to repay.

Comments as to Contentions of Plaintiff-in-Error.

(A) The ruling by the Commissioner of Internal Revenue was based on the theory that although ordinarily the payment of a debt would be neither more nor less than a capital transaction involving no question of income, in this case, because the debt was payable in marks, it became a dealing in foreign exchange. That is also urged by plaintiff-in-error.

The answer to that contention is that the case at bar involved no dealing in foreign exchange, because it was strictly an instance of the borrowing by the taxpayer of money which the bank agreed to loan if repayable in marks or their equivalent in United States gold coin. The taxpayer did not want marks, did not use marks, and never dealt in marks. As to this contention we can add nothing to the reasoning of the District Court in disposing of it (R., pp. 54-55).

(B) The brief of the plaintiff-in-error is built up on the premise that the taxpayer realized a *cash gain* in 1921. That premise is asserted, but a realized "cash gain" in the transaction is nowhere indicated or pointed out. All the cash that the taxpayer ever received in the transaction was the money which it received as loans in the years 1911, 1912 and 1913, and those borrowings were purely and simply capital transactions. Those moneys were lost years before 1921. The taxpayer did not realize any "cash gain" in 1921 or at any other time. All that can

be pointed out as to the culmination of the transaction in 1921 was a *cash disbursement, not a cash gain*, a settlement of an indebtedness involving *payment* rather than any *receipt* of cash.

It is claimed that liabilities were reduced and because of that fact there was an income. Such argument is untenable, because in many transactions there may be increase of assets, accretion of capital, and additional book values and yet no income realized. As this Court held in *Eisner* v. *Macomber, supra*, such things do not constitute "income" if there has never been anything severable from the capital received by the taxpayer or coming into the taxpayer upon which the taxpayer could put its hands as income within the common ordinary use or meaning of that term as contemplated and intended by the Sixteenth Amendment.

(C) It is urged by plaintiff-in-error that the taxpayer having loaned the money borrowed from the bank, to its subsidiary, H. S. Kerbaugh, Incorporated, and the subsidiary having lost it in the construction contracts, no loss of the borrowed funds was suffered by the taxpayer, because H. S. Kerbaugh, Incorporated, may at some time in the future pay it back. The answer to that contention is that the facts show that the taxpayer owned all of the stock of H. S. Kerbaugh, Incorporated. The tax return upon which this tax was assessed and paid shows that it is a consolidated tax return of the taxpayer and H. S. Kerbaugh, Incorporated, required by the law and regulations as then in force. All of the borrowed money having been lost by the subsidiary, re-

payment of the amount by the subsidiary to the taxpayer would not in any way change the taxable status of the taxpayer and its subsidiary, for, in view of the consolidated return, it would be exactly like a man taking money out of one pocket and putting it into another.

The case of *Carbon Steel Company* v. *Lewellyn*, 251 U. S. 501, cited by the plaintiff-in-error, involved the question of taxation of contractors as distinguished from subcontractors, and a mere reading of the quotation from that case shows its inapplicability to a parent corporation and its subsidiary.

(D) It is next argued by plaintiff-in-error that with respect to *the time of realization* of the supposed "gain", the transaction is analogous to a "short" sale. That because it was held as to a *loss* under a "short" sale in the case of *People ex rel. Keim* v. *Wendell*, 193 N. Y. Supp. 143, that the *loss* is sustained when the transaction is completed by "buying in" the thing sold "short", it must follow in the case at bar that the transaction in question was consummated in 1921 in such a way as at that time to constitute a taxable *gain*. The *Keim* case did not involve or determine any question of *gain*.

The instant transaction, however, *was not a short sale*, the difference between it and a short sale of a stock or commodity being that in the case of a short sale the money received on the sale of the borrowed stock or commodity is deposited and left with the lender as his security.

In the case at bar we have only the case of a loan, with the money loaned delivered to the taxpayer (the borrower), for its use and used by it.

To illustrate the fallacy of the contention of the

plaintiff-in-error and the difference between the instant transaction and a short sale, it is only necessary to consider the way in which what is ordinarily known as a short sale is carried out.

The person selling "short" borrows either directly or through his broker from another the stock or commodity to make delivery for the purpose of consummating the sale. The proceeds of that sale when received are not released to the seller, but, on the contrary, are delivered to and held by the lender and constitute the lender's security for the return of the stock or commodity and assurance to him that he can "buy in" if necessary, and the proceeds to an amount equal to the market price of the stock or commodity are held by the lender until the stock or commodity is returned to him. In addition, the seller is required to deposit margin sufficient to assure against a possible rise in the market price of the stock or commodity; in other words, the seller not only does not receive the proceeds of the sale at the time the sale is made, but in addition, must invest other of his independent capital as security, that is, as "margin". When the seller elects to return the stock or commodity borrowed, an equal amount of the stock or commodity is purchased or provided by the seller to replace that which was borrowed. The difference in the market price at the time of closing determines whether profit or loss is made.

If the instant transaction could either be considered as a short sale or as having any element of a short sale, it would have been necessary for the money *to have been held by the bank, as its security for the return of the marks, and that would have defeated the whole purpose and intent of the transaction.*

In the case at bar, contrary to the basic element of a

short sale, the loan secured by the taxpayer from the bank was released to its use, and lost by it so that there was none of the loan left in 1921; nor has the taxpayer had adequate credit for those losses in its income tax returns, because of the fact that the losses in the years 1913, 1914, 1916, 1917 and 1918 exceeded its income in those years by more than the amount of the item in question. The repayment was made from funds of the taxpayer other than those borrowed from the bank which had been lost. The taxpayer *paid out* its money, *received nothing* in, and the effect of the payment which it made was *to further deplete the taxpayer's capital and assets*, in addition to the total loss of all of the moneys borrowed.

(E) Plaintiff-in-error next argues that the transaction is analogous to the repurchase by a corporation of its own bonds at a price less than the issuing price. This Court has not decided that taxable income would result from such a bond transaction. The distinction, however, between such a transaction and the case at bar, is that in the case at bar the taxpayer never agreed to pay any fixed amount in dollars. It agreed to repay a certain number of marks or their equivalent, and that is exactly what, and only what, it has done.

In the corporate bond transaction, the debtor buys in its own obligation for less than the amount of the debt. By so doing it becomes possessed at a price of its own obligation which otherwise it must pay on the due date at its full amount.

In the case at bar, no such thing was done; the debtor (the taxpayer) simply paid to its creditor the full amount of its obligation.

Many reasons occur to counsel as to why under the facts of the so-called corporate bond ruling, no taxable income would accrue; that case, however, is not before this court, and in view of the distinguishing features of the case at bar, it would serve no useful purpose and only unduly lengthen this brief to enter upon a detailed discussion of the question.

(F) Plaintiff-in-error next urges that the decision in *Great Northern Railway Company* v. *Lynch*, 292 Fed. 903, is applicable to the case at bar. By that decision the principal contentions of the taxpayer were sustained, and judgment given to it for the principal part of what was claimed in the suit. As to two small items of $70.01 and $44.88, the District Court ruled against the taxpayer. The two small items aggregating $114.89 were the result of an assessment of 1% upon items of indebtedness barred by the Statute of Limitations and which had been charged off by the taxpayer at the expiration of the period of limitation. The decision having been largely in the taxpayer's favor, the small items in question were not reviewed and neither this Court nor the Circuit Court of Appeals has ever considered that question. We feel that had such items been important enough to warrant an appeal, upon any such consideration of them, the result would have been otherwise. But even if we assume, for the sake of argument, the correctness of the decision in *Great Northern Railway Company* v. *Lynch*, *supra*, nevertheless there is complete lack of analogy between that case and the case at bar for, in the case at bar, the taxpayer did exactly what it agreed to do and paid exactly what it agreed to pay. It paid its debt in full, and there was no cancellation of the debt or any part of it, either by operation of law or otherwise.

(G) Under Point II plaintiff-in-error states that the District Court finally based its decision on the case of *United States* v. *Oregon-Washington R. and Nav. Co.*, 251 Fed. 211. The Court below held that the item which the taxpayer was required to include as income was not income under the Sixteenth Amendment, basing that holding on the decisions of this Court in *Eisner* v. *Macomber, supra; Merchants' Loan & Trust Co.* v. *Smietanka, supra, and United States* v. *Phellis, supra.* In disposing of a claim urged on the argument in the Court below that an increase in assets must constitute income; the Court below cited and followed the opinion of the United States Circuit Court of Appeals in the *Oregon-Washington* case to the effect that increases in assets, or decreases in liabilities do not necessarily constitute taxable income; in other words, that where, as here, there was a mere decrease of book liability, that decrease of book liability would not be taxable income in any sense of the word "income".

II.

If it be assumed for the sake of argument that the item of $684,456.18 was income, that sum *was not received in 1921* and was not income in that year.

Section 213 of the Revenue Act provides:

> "* * * The amount of all such items * * * shall be included in the gross income for the taxable year in which received by the taxpayer * * *."

If, contrary to the numerous decisions of this Court, as we interpret them, it be assumed for argument that the item of $684,456.18 does constitute taxable income received by the taxpayer such income was not received *in the year 1921*, and could not have been received in that year because it had totally disappeared years before.

The only period of time during which anything of value was received by the taxpayer was at the time it delivered its notes to the bank in 1911, 1912 and 1913. At the time these funds were received by the taxpayer, clearly they did not constitute income. What took place then was purely and simply a capital transaction, *i. e.*, the taxpayer's obligation was exchanged for its equivalent in funds, out of which no profit, gain or income of any character arose.

Subsequent to the borrowing of the funds and during the operations of the taxpayer and its subsidiary, no taxable income or anything of value, separate and apart from the borrowed capital, was derived from such capital or accrued to the taxpayer for its use; indeed, instead of a profit, gain or income, the taxpayer suffered losses during all of the years until finally the entire amount of the funds thus borrowed was completely wiped out.

When the payment to the Alien Property Custodian was made in the year 1921, the taxpayer found itself in the situation where, instead of a profit, gain or income having accrued to it during the intervening years, the entire amount of the borrowed capital had been lost. In order, therefore, to make the payment to the Alien Property Custodian, it was necessary for the taxpayer to use other of its capital funds. When the settlement was made in 1921, nothing tangible or of

value came to the taxpayer, and all that was done was simply the payment of an obligation contracted years before. That being the situation, it is inconceivable to assume that *during the year 1921*, the taxpayer received anything of value of any character whatsoever which might have been derived from either the employment of its capital, of its labor or of both combined, or from the sale or conversion of its capital assets.

CONCLUSION.

Every decision of this Court is to the effect that income must be a definite, affirmative, realizable thing.

To tax a reduction of liability reflected in mere book entries would be to set up for taxation purposes something negative and impossible of realization.

The word "income" as used in the Amendment is clearly inconsistent with taxing any such thing.

The taxpayer neither *received*, nor *drew*, nor had to his own separate use, benefit and disposal in 1921 or at any other time any sum of money or other thing of value which would constitute income under the decisions of this Court.

If there were any doubt as to the meaning of the word "income" as affecting the taxability of the item involved, the judgment should then be affirmed under the rule recently reiterated by this Court in *United States* v. *Merriam*, 263 U. S. 179, at page 188, to the effect that "If the words are doubtful, the doubt must be resolved against the Government and in favor of the taxpayer. *Gould* v. *Gould*, 245 U. S. 151."

It is respectfully submitted that no error was committed by the District Court and that the judgment should be affirmed.

Respectfully submitted,

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